PENSION REFORM FOR STATE AND LOCAL EMPLOYEE RETIREMENT SYSTEMS

HEARING

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

S. 2105 and S. 2106

MARCH 29, 1982

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

94-412 O WASHINGTON: 1982 HG 97-83

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PENSION REFORM FOR STATE AND LOCAL EMPLOYEE RETIREMENT SYSTEMS

MONDAY, MARCH 29, 1982

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

The subcommittee met, pursuant to notice, at 9:35 a.m. in room 2221, Dirksen Senate Office Building, Hon. John H. Chafee (chairman of the subcommittee) presiding.

Present: Senators Chafee and Matsunaga.

[The committee press release announcing this hearing; the bills S. 2105 and S. 2106; the description of these bills by the Joint Committee on Taxation; and Senator John Chafee's statement follow:]

[For Immediate Release, Press Release No. 82-113]

U.S. SENATE,
SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY,
COMMITTEE ON FINANCE,
Washington, D.C., March 18, 1982.

FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY SETS HEARING ON PENSION REFORM FOR STATE AND LOCAL EMPLOYEE RETIREMENT SYSTEMS

Senator John H. Chafee (R., R.I.), chairman of the Subcommittee on Savings, Pensions, and Investment Policy announced today that the subcommittee will hold a hearing on March 29, 1982 on pension reform for State and local employee retirement systems.

The hearing will begin at 9:30 a.m. in room 2221 of the Dirksen Senate Office Building.

The following legislative proposals will be considered at the hearing:

S. 2105 and S. 2106.—Introduced by Senator Chafee. S. 2105 and S. 2106 would generally reform State and local employee retirement systems by requiring basic reporting, disclosure, and fiduciary standards.

STATEMENT BY HON. JOHN H. CHAFEE

Good morning. Welcome to the first hearings ever held in the Senate on the Public Employee Retirement Income Security Act, PERISA. We have two bills before the subcommittee today, S. 2105 and S. 2106.

Both bills have the same objective: To require basic reporting, disclosure and fiduciary standards be met by all public employee pension plans; standards that will protect the rights and benefits of public employees, as well as the interests of the taxpayers who fund our Nation's public pension systems. The reason for introducing two bills, which are similar but differ in several provisions, is to provide the Senate with an opportunity to consider more than one approach to the impending crisis in public pension funding.

As chairman of the Senate Finance Subcommittee on Savings, Pensions, and Investment Policy, as a former Governor, and as a citizen taxpayer, I have been concerned for a long time about the major problems facing State and local government retirement systems. Whether you look to the comprehensive report on public plans issued in 1978 by the House pension task force or to a host of other private and Government studies, it is clear that a crisis now exists in the operation of many State and local government pension plans.

Many plans are dangerously underfunded and have accumulated staggering amounts of unfunded liabilities.

All too frequently, important information on these plans' benefits and financial condition is not regularly disclosed to participants, to public officials, or to the taxpayers.

Fiduciary standards which guide the investment and management practices of many plans are wholly inadequate to safeguard assets; they come nowhere near what is expected, and in fact, required in the private-sector pension community.

Some pension experts have characterized the public pension situation as a "ticking time bomb." While that may sound dramatic, it is clear we can no longer ignore a major area of national concern. The deteriorating financial condition of many public plans threatens not only the benefits of future retirees, but the pocketbooks of the taxpaying public. Should a major State or municipal plan go broke, it is entirely possible that the Federal Government will be called upon for the bailout. We can avoid this situation if Congress will take steps now to establish the same minimum standards for public plans as it has set for private sector pension funds, in the areas of reporting, disclosure and fiduciary conduct.

Such action was called for in the report of the President's Commission on Pension Policy, issued 1 year ago:

"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."

During hearings my subcommittee held last May on the President's Commission Report, this position was also strongly endorsed by the American Federation of State, County & Municipal Employees [AFSCME].

What does PERISA do?

It requires an annual report by each fund disclosing the plan's assets, liabilities, funding policy, changes in such policy, and transactions with any parties in interest.

It requires that pension funds hire an actuary to evaluate the plan at least once every 3 years.

It requires the plan administrator to provide information, on request of plan participants, regarding accumulated benefits and the extent to which benefits are vested.

It establishes fiduciary responsibilities similar to those under private pension plans. Assets would have to be held for the exclusive purpose of providing benefits to plan participants and defraying reasonable administrative costs.

It also establishes prohibited transaction rules similar to those under private plans. Fiduciaries would be prohibited from dealing in self-interest or any other interest but that of the beneficiaries. All investments and transactions must meet an "adequate consideration" test. And plans would be prohibited from investing more than five to ten percent of assets in the employer's securities.

Some of the PERISA issues I expect to be widely discussed by the Senate are laid out in the differences between the two bills. One of those is the question of whether a single agency should be created to streamline the regulatory process which is now shared between the Internal Revenue Service and the Labor Department. Another involves the kind of system we should establish for exempting State and local plans from PERISA jurisdiction. Should the States certify their own exemption or should the Labor Department retain that responsibility?

PERISA and the goal of restoring health to the Nation's public employee pension funds has been given top priority by such distinguished organizations as the Service Employees International Union, the National Education Association, the AFL-CIO Public Employee Department and, as I have indicated, the American Federation of State, County & Municipal Employees.

My bills mandate no added financial burdens on State and local governments, such as requiring certain funding levels be met. That is clearly a decision to be made at the local level.

We simply require that the financial condition of these funds be systematically reviewed and the information be made available to the public on a regular basis. It further requires that those who have management or administrative responsibility for public pension funds meet the same, widely accepted standards of conduct currently expected of private pension fiduciaries.

PERISA is not, nor should it be, a partisan issue. It is sponsored in the House by ranking Members on both sides of the aisle. It should be supported by Republicans and Democrats and by Conservatives and Liberals alike, because it clearly is in the best interest of State and local governments, their employees and the public at large.

I urge my colleagues to join me in seeing this legislation through the Senate this year.

DESCRIPTION OF S. 2105 and S. 2106

RELATING TO

STATE AND LOCAL PUBLIC EMPLOYEE BENEFIT PLANS; ADMINISTRATION OF EMPLOYEE BENEFIT PLANS

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The Subcommittee on Savings, Pensions, and Investment Policy of the Senate Finance Committee has scheduled a public hearing on March 29, 1982, on S. 2105 and S. 2106 (introduced by Senator Chafee). The bills deal with the treatment of State and local public employee retirement systems, and would amend the Employee Retirement Income Security Act of 1974 (ERISA) relating to public employee retirement plans. In addition, S. 2105 would establish an Employee Benefit Administration, and would amend the Code as well as ERISA. The bills have been referred jointly to the Committee on Finance and the Committee on Labor and Human Resources.

This pamphlet is prepared by the staff of the Joint Committee on Taxation in connection with the Subcommittee's March 29 hearing. The first part of the pamphlet is an overview of public employee retirement systems and the scope of the bills. The second part is a summary of S. 2105 and S. 2106. The third part is an explanation of the provisions of the bills, including the relevant provisions of present law. Finally, part four is a statement regarding possible budget effects of the bills.

I. OVERVIEW

A. Background on State and Local Public Employee Retirement Systems

Financial status of plans

The 1977 Census of Governments counted 3,075 public employee retirement systems administered by State and local governments, distributed as follows (table 1):

TABLE 1.—NUMBER OF STATE-LOCAL PUBLIC EMPLOYEE RETIREMENT SYSTEMS IN 1977

Type	Number	Percent of total
State administered	197	6.4
Locally administered	2,878	93.6
Counties	165	5.4
Municipalities	2,420	78.7
Townships	194	6.3
School districts	83	2.7
Special districts	16	.5
Total	3,075	100.0

Source: 1977 Census of Governments, U.S. Bureau of the Census.

Several studies conducted since 1977 indicate that there now may be as many as 5,000 State and local government plans. They represent a major source of future retirement income for more than 9 million State and local government employees and dependents. Current benefits are paid to about 2.4 million persons.

In pension system reports to the Census Bureau for fiscal years that ended between July 1979 and June 1980, State and local government employee retirement systems reported annual receipts of $37.3 billion. Employee contributions accounted for 17 percent of that amount and investment earnings 36 percent; the rest—47 percent—were contributions from State and local governments (see table 2). Benefit payments and employee withdrawals of contributions amounted to $14 billion.

TABLE 2.—NATIONAL TOTALS OF STATE AND LOCAL PUBLIC EMPLOYEE RETIREMENT SYSTEM FINANCES, FISCAL YEAR 1980

[Millions of dollars]

Item	All public systems	State-administered systems	Locally administered systems		
			Total	Municipal	Other
Receipts	37,313	28,603	8,710	6,544	2,166
Employee contributions	6,466	5,285	1,180	751	429
Government contributions	17,532	13,010	4,521	3,558	963
From States	7,581	7,399	181	111	71
From local governments	9,951	5,611	4,340	3,447	893
Earnings on investments	13,315	10,308	3,008	2,234	774
Benefits and withdrawal payments	14,008	10,257	3,752	2,929	823
Benefits	12,207	8,809	3,399	2,698	701
Withdrawals	1,801	1,448	353	231	123
Cash and security holdings at end of fiscal year, total	185,226	144,682	40,544	29,992	10,552
Cash and deposits	4,220	2,647	1,572	932	640
Governmental securities	36,775	26,724	10,051	8,163	1,888
Federal	32,750	26,213	6,537	4,658	1,878
United States Treasury	17,520	13,814	3,706	2,613	1,093
Federal agency	15,230	12,399	2,831	2,045	786
State and local	4,025	511	3,514	3,505	9
Nongovernmental securities	144,232	115,311	28,921	20,897	8,024
Corporate bonds	75,037	60,871	14,166	9,879	4,287

TABLE 2.—NATIONAL TOTALS OF STATE AND LOCAL PUBLIC EMPLOYEE RETIREMENT SYSTEM FINANCES, FISCAL YEAR 1980—Continued

[Millions of dollars]

Item	All public systems	State-administered systems	Locally administered systems		
			Total	Municipal	Other
Corporate stocks	38,590	31,146	7,444	5,417	2,026
Mortgages	12,843	11,966	877	516	361
Other securities	16,238	10,677	5,561	4,615	946
Other investments	1,524	651	874	470	404

Note.—Because of rounding, detail may not add to totals.

Source: U.S. Bureau of the Census, "Finances of Employee Retirement Systems of State and Local Governments in 1970–80", p. 3.

At the end of fiscal year 1980, State and local pension systems held financial assets of $185.2 billion, as shown in table 2. Investment in nongovernmental securities amounted to $144.2 billion, or 79 percent, $36.8 billion in government securities, or 20 percent, and the rest was held in cash and deposits. The bulk of governmental securities held had been issued by the Federal Government, and the holdings were almost evenly divided between Treasury and federal agency issues. Bonds constituted more than half of the nongovernmental securities, and about one-quarter of the total were corporate securities. The rest of the assets were in mortgages and other securities and investments.

Administrative costs of the employee retirement systems have been excluded from these data because such costs primarily are met directly by the government involved, rather than by the retirement system as a separate entity. As a result, such data are not reported with other information concerning retirement systems.

Funding pension plans

State and local government employment increased at faster rates from 1950 through the 1970's than federal government or private sector employment. An inevitable association has been the expansion in the number and size of State and local government pension plans and in the costs and benefit payments. Inflation, greater labor mobility and earlier retirements, especially from public sector employment, have complicated the increasing burdens on public pension systems. A reasonable summary of the situation can be presented in a discussion of the decisions that must be faced in funding a pension system.

The objectives and limitations of the pension program must be defined first. Usually, public employee retirement benefits are based on the number of years of service, a measure of gross salary and a maximum benefit (ceiling) expressed as a percentage of the salary measure. Plans of this type are referred to as defined benefit plans. If liabilities under a defined benefit plan are to be funded in advance, estimates must be made with respect to such factors as the number of employees who will qualify for benefits, the salary levels upon which their benefits will be based, and their life expectancies (and those of their survivors). Also, estimates must be made as to the interest rates to be earned on plan assets.

An additional matter relates to inflation and cost-of-living adjustments that restore in full or part the loss in purchasing power. It is common for public pension plan contracts to provide for periodic adjustments, and those lacking a formal commitment often make such adjustments periodically by legislative action. If the inflationary adjustments have not been funded, cost-of-living adjustments conceivably could increase, or create, a plan's unfunded liability.

Funding a pension plan involves estimating the future time pattern of benefit payments and arranging a pattern of contributions to a fund which, with accumulated interest earnings, will be able to finance benefit payments. Alternatively, a pension fund may be established by a legislature that requires employee contributions at a specified percentage of payroll and annual appropriations that make up the difference between benefit payments and employee contributions; this is a pay-as-you-go system.

Most public defined benefit pension funds have unfunded liabilities on an actuarial basis. Recommendations to achieve full funding involve amortizing the estimated deficit over a period and reaching an equilibrium state of full funding thereafter. Failure to do so implies a pattern of pension costs which may increase at an increasing rate over time. Such a pattern may overburden an employer and may result in a curtailment of benefits.

Estimating the correction to be made involves estimating the levels and paths of several variables. The time pattern for the estimating period must project levels of employment, wages and salaries, real income, inflation, interest rates, average employment tenure, retirement age, and life expectancy of employees and dependents eligible for survivor benefits. Some of the variables are mutually reinforcing and others are offsetting. Different rates of change and time patterns of change also will produce mutually reinforcing and offsetting changes. The calculations of fully funded or unfunded liability are precise, but only after actuarial assumptions have been made about how the relevant variables will change in the future.

B. Scope of S. 2105 and S. 2106

In general

Under similar provisions of S. 2105 and S. 2106, the administrator of a public employee pension benefit plan would be required to meet reporting and disclosure standards. In addition, the bills would (1) prescribe a "prudent man standard" and other standards for fiduciaries of public plans, (2) prohibit certain transactions between fiduciaries and plans, and (3) require that fiduciaries of public plans be bonded. The provisions of the bills would be enforced by civil actions. A public plan would be subject to Federal standards except that, in some cases, plans would be exempt from Federal standards if State law provides for equivalent standards. The bills do not apply to Federal pension plans.

Under S. 2105, a public employee pension benefit plan that meets the reporting, disclosure, and fiduciary requirements of the bill would be treated as a qualified plan under the Internal Revenue Code. Also, S. 2105 would require that the President establish a new agency, the Employee Benefit Administration (EBA), to administer the provisions of the bill. The bill would generally transfer, from the Internal Revenue Service to the new agency, administration of the provisions of the Internal Revenue Code relating to qualified pension, profit-sharing, and stock bonus plans, to deferred compensation plans of State and local governments to certain health, legal, and fringe benefit plans, and to IRAs. The new agency would also administer the provisions of ERISA presently administered by the Department of Labor. The Pension Benefit Guaranty Corporation would also be transferred to the EBA.

Question of Federal authority

Questions have been raised as to Federal authority to regulate the employment practices of a State or local government with respect to its employees. Some commentators believe that the decision of the Supreme Court in *National League of Cities* v. *Usery* [1] indicates that Federal authority under the Commerce Clause of the Constitution does not extend to the regulation of State and local wage and benefit practices.[2] Others argue that the case has been interpreted narrowly by the Courts and that the provisions of the bill would withstand a constitutional challenge.[3]

[1] 426 U.S. 833 (1976). In *National League of Cities*, the Supreme Court considered the 1974 amendments to the Fair Labor Standards Act under which minimum wage and maximum hour provisions of Federal law were generally extended to employees of States and their political subdivisions. In a 5-4 opinion, the Court held that the amendments were not within the authority granted to the Congress by the Commerce Clause. The Court held that the amendments would impair the State's ability to function effectively in a federal system and specified that the Congress may not exercise its power to regulate commerce so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made.

[2] *State and Local Pension Systems—Federal Regulatory Issues*, Advisory Commission on Intergovernmental Relations, December 1980 (p. 5).

[3] See Pension Task Force Report on Public Employee Retirement Systems, Committee on Education and Labor of the House of Representatives, 95th Cong., 2nd Sess., March 15, 1970 (p. 17 et. seq.).

II. SUMMARY OF THE BILLS

Coverage

The bills (S. 2105 and S. 2106) would cover most public employee pension benefit plans maintained by any State or local government which provide retirement income to employees or which permit the employees to defer income for periods extending to or beyond the termination of covered employment. The bills would not apply to public employee pension benefit plans maintained by the Federal Government or any agency or instrumentality thereof.

Reporting and Disclosure

S. 2105

The bill would require that a public employee pension benefit plan comply with reporting and disclosure standards. The standards would require that public plans file a registration statement identifying the plan, retain records, and establish a claims procedure. Pension plans would be required to publish a summary plan description and an annual report which includes a financial statement, an actuarial report, and, in some cases, a report from insurance companies from which the plan has purchased benefits. The reporting and disclosure rules would be administered by the Employee Benefits Administration (EBA), a new agency established by the bill. Plans required to meet equivalent standards under State law would be exempt from certain of the Federal requirements.

S. 2106

The bill is substantially the same as S. 2105, except that it would not establish an Employee Benefit Administration. Instead, the reporting and disclosure rules for public plans would be administered by the Secretary of Labor.

Fiduciary Responsibility

S. 2105

Under the bill, standards would be established for fiduciaries of pension plans for employees of State and local governments. The bill would also define certain acts of self-dealing as prohibited transactions.

The bill would require that covered plans be in writing and that all plan assets be held by a trust or by an insurance company. Under the bill, a public plan would generally be required to provide plan trustees with exclusive authority and discretion to manage and control plan assets. Bonding would be required for plan fiduciaries and certain plan employees.

All plan fiduciaries would be required to act in accordance with a "prudent man" standard. In addition, plan fiduciaries generally would be required to diversify plan investments (up to 10 percent of plan assets could be invested in qualifying employer securities, obligations, and real property), and would be required to act for the exclusive benefit of the plan participants and beneficiaries. Fiduciaries would be personally liable for losses sustained by a plan that result from violation of these rules.

The bill generally would prohibit a fiduciary (1) from dealing with the income or assets of a plan in his own interest or for his own account, (2) from ~~acting in any~~ transaction involving the plan on behalf of a person (or representing a party) whose interests are adverse to the interests of the plan or of its participants or beneficiaries, and (3) from receiving any consideration for his personal account from any party dealing with the plan in connection with a transaction involving plan assets. However, the bill would authorize the Employee Benefit Administration (EBA) to establish an administrative procedure for granting exemptions from the prohibited transaction rules and would also provide certain statutory exemptions.

S. 2106

The bill is substantially the same as S. 2105 with respect to fiduciary standards, except with respect to certain definitions of prohibited transactions and fiduciary duties and the limits on the acquisition of qualifying employer securities. Under S. 2106, prohibited transactions include certain transactions between a plan and a party-in-interest as well as acts of self-dealing by the fiduciary. Further, under certain circumstances, a fiduciary is made explicitly liable for breaches made by each co-fiduciary. The overall limit on acquisition of qualifying employer securities, etc. is reduced to five percent of plan assets.

Administration and Enforcement

S. 2105

Responsibility for administering the bill's provisions relating to public employee pension benefit plans would be assigned to the Employee Benefit Administration (EBA), a new Federal agency established by the bill. The EBA, State attorneys general, and other specified persons could bring civil actions against fiduciaries and plans to collect penalties and to otherwise enforce the provisions of the bill. Federal court jurisdiction is provided for the bill's fiduciary standards. Concurrent State and Federal jurisdiction is generally retained for other civil actions.

S. 2106

The bill is substantially the same as S. 2105, except that the bill would not establish an Employee Benefit Administration. Instead, the bill's provisions would be administered and enforced for the United States by the Secretary of Labor.

Tax-Qualification of Government Plans

Under S. 2105 only, the tax-qualification rules of the Internal Revenue Code for pension plans would not apply to public employee pension benefit plans. Instead, a public employee pension benefit plan which meets the requirements of the bill would be treated as a tax-qualified plan for all purposes under the Code. Accordingly, the Code's tax-qualification rules, including those prohibiting discrimination, limiting contributions or benefits, and defining prohibited transactions, would not apply.

Consolidation of Federal Administration

S. 2105

The bill would transfer to the new Employer Benefit Administration existing functions of the Departments of the Treasury and of Labor with respect to qualified pension, profit-sharing, and stock bonus plans, tax-sheltered annuities, tax-credit ESOPs, medical reimbursement plans, group legal plans, cafeteria plans, employee stock purchase plans, individual retirement accounts, deferred compensation plans for employees of State or local governments, voluntary employee beneficiary associations, supplemental unemployment benefit plans, employee-funded pension plans, and certain trusts established for payment of liabilities to multiemployer persion plans. Policymaking and other functions of the Secretaries of Labor and the Treasury under ERISA and the Internal Revenue Code would be transferred to the new agency. The EBA would have the authority to determine the status of pension, etc., plans under the tax laws, and to enforce ERISA standards by civil actions against plans and fiduciaries.

S. 2106

There is no provision under the bill to establish a new agency to administer pension, etc. plans. The bill's provisions relating to public employee pension benefit plans would be administered by the Labor Department. The Departments of the Treasury and of Labor and the Pension Benefit Guaranty Corporation would retain their respective responsibilities for administering and enforcing ERISA and those provisions of the Internal Revenue Code relating to employee benefit plans.

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III. DESCRIPTION OF THE BILLS

A. Coverage

In general, the bills (S. 2105 and S. 2106) would apply to any public employee pension benefit plan (i.e., any plan, fund, or program maintained by a State or political subdivision thereof, or any agency or instrumentality of any State or political subdivision) which provides retirement income to employees or which permits employees to defer income for periods extending to or beyond the termination of covered employment. The bills would apply to defined contribution and defined benefit arrangements. However, the bills would not apply to plans maintained by the Federal Government or any agency or instrumentality thereof.

In addition, the bills would not apply to (1) employee benefit plans covered by ERISA; (2) unfunded excess benefit plans which provide benefits in excess of those permitted under qualified pension, etc., plans; (3) severance pay plans; (4) agreements to cover public employees under social security; (5) individual retirement accounts, annuities, or bonds (IRAs); (6) qualified cash or deferred arrangements; (7) tax-sheltered annuity programs; (8) eligible State deferred compensation plans; and (9) workers compensation and unemployment compensation plans.

B. Reporting and Disclosure

Present Law

The Internal Revenue Code requires every employer who maintains a pension, etc., or other funded plan of deferred compensation (whether or not tax-qualified) to file an annual return stating such information as is required under Treasury regulations with respect to the plan's (1) qualification, (2) financial condition, and (3) operations. The annual return is filed on the Form 5500 series.

The Code's requirement for an annual report applies with respect to a pension or retirement plan maintained by a State or local government.[1]

Explanation of Provisions

1. S. 2105

In general

The bill would establish the Employee Benefit Administration (EBA), a new agency. Generally, the administrator of a public employee pension benefit plan would be required to register the plan and file annual reports with the EBA. The registration statement would contain the name and address of the plan and of the plan administrator as well as any other information relating to the characteristics and identity of the plan that the EBA may require. Plans of a State or local government would be exempt from the Federal reporting and disclosure requirements if the governor of the State certifies that State law applies substantially equivalent requirements, that the State possesses adequate administrative capability, and that the State would collect annual reports and provide them to the Board.

Plan summary

The administrator of each plan covered under the bill would be required to publish a summary description of the plan and furnish a copy of the summary to each participant. Distribution of copies of material modifications and periodic updated summaries would also be required. Summaries of the plan and other information would be required to be written in a way that would be understood by the average plan participant and be sufficiently accurate and comprehensive to inform participants and beneficiaries of their rights and obligations.

The summary plan description would identify the plan, its administrators, and its trustees; describe the relevant collective bargaining provisions; refer to relevant Federal, State and local law;

[1] *State of California* v. *Blumenthal* 457 F. Supp. 1309 (D.C. Ca. 1978).

describe the rules governing eligibility requirements, vesting conditions, and disqualification or ineligibility for benefits; specify the procedures governing benefit claims and redress of claims, and provide certain other information.

Annual report

In general.—The Administrator of each plan would be required to publish an annual report for each plan year. The annual report would be filed with the EBA and furnished on request to plan participants and beneficiaries and other interested persons.

Separated participants with vested pension benefits.—The annual report would identify each plan participant who separated from service in the previous plan year with a vested right to a pension benefit and who neither returned to service during the plan year nor received a pension benefit during the plan year or the preceding plan year. The report would also include the nature, amount, and form of the benefit. Information filed on an annual report with respect to a separated plan participant would be forwarded by the EBA to the Social Security Administration.

The Social Security Administration would be required to maintain records of the public retirement plans in which individuals have vested benefits, and to provide this information to participants and beneficiaries on their request and also in response to their applications for social security benefits.

Financial report.—Financial statements in the annual report would be audited by an independent qualified public accountant who would present an opinion as to whether the statements conform with generally accepted accounting principles.[2] In preparing and certifying these reports, the independent qualified public accountant would not independently verify any actuarial data. Rather, the accountant would be required to rely on the correctness of any actuarial matter certified to by an enrolled actuary. The financial statements would provide detailed balance sheet data, as of the end of the plan year, and separate, comparative summary data for the plan year and the preceding plan year.

For the plan year, the balance sheet would provide a statement of year-end assets and liabilities and of changes in net assets available for plan benefits. These statements would include appropriate details of revenues, expenses and other changes aggregated separately by general source and application. Notes to the financial statements could provide information concerning significant changes in plan benefits and whether there were any significant changes in the plan affecting benefits; the funding policy and changes in it; and material relating to activities and transactions affecting the assets and liabilities.

Year-to-year comparative summaries would describe, in appropriately aggregated categories, assets and liabilities at their current value, and receipts and disbursements. Investment assets held

[2] The Financial Accounting Standards Board has proposed to defer for 18 months the effective date of FASB Statement No. 35, "Accounting and Reporting by Defined Benefits Plans," for plans that are sponsored by state and local governmental units. In making its proposal for deferral, FASB noted that the Financial Accounting Foundation, which is responsible for organizing, funding and overseeing FASB, has agreed to organize a new governmental accounting standards setting body to replace the National Council on Governmental Accounting.

during a plan year would be described by information concerning the issuer, borrower, lessor, or other party to the transaction (including identification of a party in interest).[3] Also, the maturity date and value, rate of interest, cost and current value of each group of similar assets would be reported. However, where some or all of the assets of a plan or plans are held by an insurance carrier or a bank, the value of those assets would be certified by the insurance carrier or bank, and would not be audited by the independent qualified public accountant. In addition, detailed information would be required regarding each transaction entered into involving a person known to be a party in interest. The bill specifies information that would be required about all loans, fixed income obligations and leases that were in default or classified as uncollectable at the end of the plan year, with notation of cases where parties in interest are known to be involved. Alternative reporting requirements could be followed for investment assets placed in a trust.

Actuarial statement.—For a defined benefit plan, the annual report covering a plan year would include an actuarial statement prepared by an enrolled actuary. An actuarial valuation of the plan would be required every three years. An enrolled actuary would be required to rely on the correctness of any accounting matter with respect to which the independent qualified accountant has expressed an opinion.

The actuarial statement would show the total amount of contributions made or expected to be made for the plan year by the participants, employers and all others. In addition, previously unreported contributions received during the plan year that apply to preceding plan years would be reported. The report would show the estimated total covered compensation of active participants, as well as the number of active participants, terminated participants eligible for deferred vested pension benefits (or return of participant contributions), and all other participants and beneficiaries included in the most recent actuarial valuation. Included in the report would be the values, as of the most recent actuarial valuation, of the current assets accumulated in the plan, the amount of accumulated mandatory and voluntary contributions made for active participants, and specified details of the funding of the plan.

The bill also would require statements of the most recent computation of the actuarial present value of (1) all future plan benefits for active participants and terminated participants eligible for deferred vested benefits (or return of contributions), of (2) accumulated plan benefits for vested and nonvested active participants, of (3) total projected plan benefits, of (4) future covered compensation and of (5) the plan assets.

Insurance organization.—If some or all of the pension plan benefits are to be purchased from one or more insurance organizations, the annual report for the plan year would include a statement from the insuror with information on the premium rates or subscription charges paid; the total amount of premiums received, persons covered by each benefit class and total claims; dividends or

[3] The term "party in interest" refers to individuals and organizations employed by or providing services to the plan.

retroactive rate adjustments and selected other administrative details.

Information for participants, beneficiaries, et. al.

Within prescribed time limits, the administrator would furnish to each participant or beneficiary of the plan a copy of the summary description of the plan, and distribute to them information about amendments and modifications of the plan that may reasonably be expected to affect future benefits. Additional information or copies would be available on written request and at a reasonable charge.

Reports of benefit rights

Each participant or beneficiary would be entitled to receive annually the latest information available concerning the total accumulated plan benefits; the extent to which benefits are, or will, become vested; the earliest date on which the accumulated plan benefits may become vested; and the total accumulated contributions made by the participant, including any interest, under the terms of the plan. The information could be provided in the annual report or in a separate statement. Analogous information would be available to separated participants entitled to vested benefits. Each participant who requests would be furnished information about the alternative forms of benefits payments that would be available.

Filing with the EBA

The administrator of each public employee pension benefit plan would be required to file a copy of the annual report for the plan year with the EBA within 210 days after the close of the plan year. Additional relevent material also would be filed. The EBA would make the report and additional information available for inspection in the EBA's public document room. The EBA could reject what it determined to be an incomplete filing or a filing with any material qualification in the statement by an actuary or accountant. If a revised filing were not submitted within 45 days after the rejection, the EBA could, at the plan's expense, retain a qualified public accountant or enrolled actuary to perform an audit or prepare an actuarial report, or the EBA could bring a civil action to require an appropriate filing.

Records and documents that would be required to reconstruct or verify any information under these disclosure provisions would be required to be kept available for at least six years after the required filing date.

A review procedure would be required to provide full and fair review of an action that denies a claim for benefits.

Alternative methods of compliance; exemptions

The EBA could prescribe an alternative method of satisfying any of the requirements for reporting and disclosure if (1) the alternative method would provide adequate disclosure to participants and beneficiaries and adequate reporting to the EBA, and (2) the alternative method would decrease plan costs substantially or avoid unreasonable administrative burdens. The EBA also could exempt any plan from meeting any of the reporting and disclosure requirements where necessary and appropriate in the public interest.

2. S. 2106

The requirements for reporting and disclosure by public employee pension benefit plans would be substantially the same as would be provided under S. 2105. Under S. 2106, however, the Secretary of Labor would be responsible for administering the provisions of the bill.

Effective Date

These provisions of the bills would be effective at the beginning of the second calendar year following the date of the submission of the report by the Advisory Council on Government plans.

C. Fiduciary Responsibility

Present Law

Under present law, a pension plan is a qualified plan if it meets the requirements of the Code Section 401(a). A trust forming a part of a qualified pension plan is also exempt from tax if certain requirements are met, including a requirement that, under the trust instrument, it is impossible, at any time before the satisfaction of all liabilities to employees and their beneficiaries, for any part of the corpus or income to be used or divested for purposes other than the exclusive benefit of employees or their beneficiaries. In addition, certain pension trusts, including a trust under a governmental plan,[1] are not exempt from taxation if they engage in any of the prohibited transactions provided by the Code (sec. 503(a) and (b)).

Under administrative rulings, an investment generally meets the "exclusive benefit" requirement of the Code if (1) the cost of the investment does not exceed fair market value, (2) a fair return commensurate with the prevailing rate is provided, (3) sufficient liquidity is maintained to permit distributions, and (4) the safeguards and diversity that a prudent investor would adhere to are present.

The Code (sec. 503) prohibits certain transactions between a plan and certain interested persons. The prohibited transactions include the lending of funds to certain interested persons without receipt of adequate security and a reasonable rate of interest, payment of excessive salaries, providing the trust's services on a preferential basis, substantial purchases or sales of property for other than adequate consideration, and engaging in any other transaction which results in a substantial diversion of trust assets. If the trust engages in any prohibited transaction, it loses its tax-exempt status for at least one year.

Interested persons include a person who creates, maintains, or makes a substantial contribution to the plan.

Explanation of Provisions

1. S. 2105

In general

The bill would establish rules for plan administration. It would also define certain acts of self-dealing as prohibited transactions.[2]

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[1] A governmental plan is a plan established and maintained for its employees by the Government of the United States, by any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing (sec. 414(d)).

[2] These rules are generally similar to the fiduciary and prohibited transactions rules made applicable to private employee plans by ERISA.

Under the bill, all plan fiduciaries would be required to act in accordance with a "prudent man" standard. In addition, plan fiduciaries generally would be required to diversify plan investments (with certain exceptions for plans that invest in qualifying employer securities) and must act for the exclusive benefit of the plan participants and beneficiaries. The bill would also require that all plans be in writing, that plan assets generally be held in trust, and that trustees generally have the exclusive authority to manage and control plan assets. However, asset management in certain circumstances could be delegated to qualified investment managers. The bill would also permit plan trustees to allocate their responsibilities if the plan so provides.

Fiduciaries would be personally liable for losses sustained by a plan that result from violation of these rules.

Plan administration

Establishment of the plan

Under the bill, every covered plan would be required to be established and maintained pursuant to written instruments. For this purpose, the term "instrument" would include a law of any State or political subdivision. The plan document would be required to provide for a named fiduciary who is to have authority to control and manage the plan operations and administration.

Plan contents

Under the bill, each plan would be required to state whether a funding policy or goal has been established for the plan. In addition, the funding policy or goal, the method of carrying out the policy, and the source of funds for the plan must be described in the plan.

The plan would be required to provide procedures for determining whether employer contributions are made in a timely fashion and for resolving any disputes as to the timing or amount of contributions.

With respect to benefits, the plan would be required to specify the criteria for eligibility, the applicable level of promised benefits, and the timing, form, and method of payment.

The bill would also require the plan to describe procedures for any allocation of duties relating to the operation and administration of the plan. Allocation and delegation of duties, including certain fiduciary duties (but not trustee duties), would be permitted only if the plan specifically provides for the allocation or delegation, and then only in accordance with the procedures established in the plan.

Each plan would also be required to provide a procedure for plan amendments and for identifying the persons who have authority to amend the plan (except to the extent that amendments are to be made by legislation). Additionally, a plan could provide that a person could serve in more than one fiduciary capacity under the plan, including service both as administrator and trustee. As described below, a plan could also provide for the hiring of advisors (including investment advisors) and investment managers.

Establishment of the trust

The bill provides that all plan assets are generally to be held in trust by trustees and also provides that the trustees would be required to manage and control the plan assets. In order that persons who act as trustees recognize their special responsibilities with respect to plan assets, trustees would be required to accept appointment before they act in this capacity.

If the plan provides that the trustees are subject to the direction of named fiduciaries, then the trustees would not have the exclusive management and control over the plan assets, but generally would be required to follow the directions of the named fiduciary. Accordingly, a plan could permit a fiduciary to appoint an investment manager. However, such investment manager would be considered a plan fiduciary.

A trust would not be required if plan assets consist solely of insurance contracts or policies issued by an insurance company qualified to do business in a State. Although these contracts need not be held in trust, the person who holds the contract would be considered a fiduciary and would be required to act in accordance with the fiduciary rules with respect to the contracts.

Exclusive benefit of employees

Under the bill, each fiduciary would be required to act solely in the interest of the plan's participants and beneficiaries. The bill would require that the assets of the plan be used exclusively to provide benefits to participants and beneficiaries or to pay reasonable plan administration costs. Therefore, the assets generally would not be permitted to inure to the benefit of the employer maintaining the plan. However, in the case of a contribution which is made by a mistake of fact or law, the bill would permit the contribution to be returned to the employer within one year after the administrator discovers the mistake.

Special asset rules

Plan assets

The bill provides rules defining the nature of plan assets. In the case of mutual funds and closed-end investment companies regulated by the Investment Company Act of 1940, the bill would not apply the fiduciary rules to the company merely because plans invest in their shares.

Similarly, the bill provides that the investment by a plan in insurance contracts or policies would not cause the assets of the insurer issuing the contracts to be considered plan assets, except to the extent that the assets are maintained by the insurer in one or more separate accounts (provided they do not represent surplus in any such account).

Transfer of assets outside the United States

The bill generally would prohibit a fiduciary from transferring or maintaining the indicia of ownership of any plan assets outside the jurisdiction of the district courts of the United States. Such a transaction could be permitted under regulations to be issued by the EBA.

Employer securities

Under the bill, a plan would not be permitted to acquire any employer securities other than qualifying employer securities, employer real property other than qualifying employer real property, or to make employer loans other than qualifying employer loans. Total plan investment in qualifying employer securities, qualifying real property, and qualifying loans would generally be limited to 10 percent of plan assets.

Under the bill, employer securities are defined as securities issued by an employer whose employees are covered by the plan, by an employer representative of such an employer, or by any affiliate of such employer of employer representative. Qualifying employer securities are defined as employer securities which are stocks or marketable obligations (including bonds, debentures, notes, certificates, and other evidences of indebtedness), provided such securities are traded on a national securities exchange or have a price otherwise established by independent persons. Securities would not be qualifying employer securities unless the plan holds no more than a quarter of the issue and independent persons hold at least one-half of the issue.

Employer real property is defined as real property leased by a plan to an employer whose employees are covered by the plan. Real property which is leased to an employer would be considered qualifying employer real property if each parcel of real property and the improvements on it are suitable (or adaptable without excessive cost) for more than one use and that where a plan holds more than three parcels of such property, the parcels are dispersed geographically. Investment in qualifying employer real property must also satisfy the usual diversification standards of the bill.

An employer loan is defined as a loan or other extension of credit (which does not constitute an employer security) between the plan and (1) the employer of employees covered by the plan, (2) an employer representative of such an employer, or (3) an affiliate of such employer or employer representative. Qualifying employer loans are employer loans bearing a reasonable rate of interest (i.e., a rate consistent with the fiduciary duties imposed by the bill) and fully secured by marketable securities.

Fiduciary duties

Prudent man standard

The bill would require that each fiduciary discharge his duties solely in the interest of participants and beneficiaries for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of plan administration. The bill would require a fiduciary to act 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 conducting an enterprise of like character and with like aims. In addition, a fiduciary would be required to diversify plan investments to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. Plan fiduciaries would be required to act in accordance with the plan documents and instruments to the extent that they are consistent with the statutory requirements imposed by the bill.

Certain individual account plans

Under the bill, a special rule is provided for individual account plans where the participant can exercise independent control over the assets in his individual account. In this case, the individual exercising control would be regarded as a fiduciary, and other persons who are fiduciaries with respect to the plan would not be held liable for any loss that results from the control by the participant or beneficiary. However, the investment could not contradict the terms of the plan, and if the plan on its face prohibits such investments, the fiduciary could not follow the instructions and thereby avoid liability.

Cofiduciary duties

Under the bill, if a plan so provides, named fiduciaries would be permitted to allocate their specific responsibilities among themselves, and named fiduciaries would be permitted to delegate all or part of their duties to others. Provided the allocation or designation does not violate the exclusive benefit or prudent man or diversification rules,[3] named fiduciaries would not be held liable for the acts or omissions of the persons to whom the duties have been properly allocated or delegated.

If the plan provides that a named fiduciary is to designate another person as a fiduciary to carry out a specific fiduciary activity, the named fiduciary would not be liable for any act or omission of that person in connection with the activity unless the designation or its continuation violates the exclusive benefit, the prudent man, or the diversification standards.

If assets of a pension plan are held by two or more trustees, the bill provides that each trustee is to use reasonable care to prevent any other trustee from breaching the fiduciary standards and that the trustees are to jointly manage and control the assets of the plan.

Prohibited transactions

Self-dealing

Under the bill, certain types of transactions between the plan and a party-in-interest would be specifically prohibited. Under these provisions, a fiduciary would be liable if he knew or should have known that he engaged in a prohibited transaction.

The bill generally would prohibit a fiduciary from dealing with the income or assets of a plan in his own interest or for his own account. However, this rule would not prohibit the fiduciary from dealings where he has an account in the plan and the dealings apply to all plan accounts without discrimination.

In addition, the bill would prohibit a fiduciary from acting in any transaction involving the plan on behalf of a person (or represent-

[3] Generally, in implementing the procedures of a plan, plan fiduciaries must act prudently and for the exclusive benefit of plan participants and beneficiaries. As a result, fiduciaries must act in this manner in choosing the person to whom they allocate or designate their duties.

ing a party) whose interests are adverse to the interests of the plan or of its participants or beneficiaries.

The bill would also prohibit a fiduciary from receiving any consideration for his own account from any party dealing with the plan in connection with a transaction involving the assets of the plan.

Administrative exemptions

Under the bill, the EBA would be authorized to grant a conditional or unconditional exemption from the prohibited transaction rules. An exemption could apply to any fiduciary or transaction, or class of fiduciaries or transactions, provided that the EBA determines (1) that such exemption is administratively feasible; (2) that the exemption is in the interests of the plan and of its participants and beneficiaries; and (3) that the exemption provides satisfactory safeguards to protect the rights of participants and beneficiaries.

Statutory exemptions

The bill would exempt the following transactions from the prohibited transaction rules:

(1) plan loans to participants or beneficiaries where such loans (a) are specifically permitted by the plan, (b) are available to all participants on a reasonably equivalent basis, (c) are not made available to certain highly compensated employees, officers or fiduciaries in an amount greater than the amount available to other employees, (d) are reasonably secured, and (e) bear a reasonable rate of interest;

(2) contracts or reasonable arrangements made with a party in interest for office space or legal, accounting, or other services necessary for the establishment or operation of the plan, provided no more than reasonable compensation is paid for these services.

(3) investment of all or a part of the plan's assets in deposits in a Federal or State-supervised bank or similar institution which is a fiduciary, provided certain requirements are met;

(4) provision of ancillary bank services by a bank or similar financial institution which is a fiduciary, if no more than reasonable compensation is charged for such services, if adequate internal safeguards are provided, and if the bank's action is in accordance with specific guidelines issued by the bank that will prevent the bank from providing ancillary services in an unreasonable or excessive manner or in a manner that would be inconsistent with the best interests of the plan's participants and beneficiaries;

(5) certain transactions between a plan and a common or collective trust fund or pooled investment funds maintained by a party-in-interest which is a Federal- or State-supervised bank or trust company, or a pooled investment fund of an insurance company qualified to do business in a State.[4]

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[4] To qualify for exemption, no more than reasonable compensation may be paid by the plan in the purchase (or sale), and no more than reasonable compensation may be paid by the plan for investment mangement by the pooled fund. Also, the transaction must be specifically provided for by the plan or by a plan fiduciary (other than the bank, etc., or its affiliates) who has authority to manage and control the plan assets.

Bonding

The bill generally would require every fiduciary of a public employee pension benefit plan (and every person who handles funds or other property of a plan) to be bonded. Generally, the amount of the bond would not be less than 10 percent of the funds handled and not less than $1,000 (nor more than $500,000, except that the EBA may prescribe an amount in excess of $500,000 which in no event may exceed 10 percent of the assets handled). The bill would not require a bond if plan benefits are paid only from the general assets of a union or employer. In addition, a bond would not be required for a domestic trust or insurance company subject to State or Federal supervision or examination if it has combined capital and surplus in excess of $1 million (or such other higher amount as determined by the EBA). However, a special rule is provided for banks or other financial institutions exercising trust powers if their deposits are not insured by the Federal Deposit Insurance Corporation. In this case, a bond will not be required if the corporation meets bonding (or similar requirements) of State law which the EBA determines are at least equivalent to bonding requirements imposed on banks under Federal law.

Civil liability

In general

A fiduciary who breaches the fiduciary requirements or prohibited transaction rules of the bill would be personally liable for any losses to the plan resulting from the breach. Such a fiduciary would also be required to restore to the plan any profits which he has made through the use of any plan asset. Also, such a fiduciary would be subject to other appropriate relief (including removal) as ordered by a court. (See also D. Administration and Enforcement, Explanation of Provisions—1. S. 2105, "Prohibited transactions.")

In addition, the bill would prohibit a person who is convicted of certain specified crimes from serving as a plan administrator, fiduciary, officer, trustee, ~~custodian~~, counsel, agent, employee, or consultant of a plan for five years after conviction or five years after the date of imprisonment, whichever is later. However, such a person would be permitted to serve as an administrator, etc., of a plan if his citizenship rights have been fully restored or if the United States Board of Parole determines that his service would not be contrary to the purposes of the Act. An individual who is named a fiduciary in violation of this provision would be subject to removal.

A plan fiduciary would not be liable for any breach of fiduciary duty if it occurred before he became a fiduciary or after he was no longer a fiduciary. In addition, a legislator acting in his or her legislative capacity (or any person acting in a governmental capacity with respect to establishing a plan) would not be considered a fiduciary by reason of legislative actions taken in connection with a government plan.

Exculpatory provisions and liability insurance

Under the bill, exculpatory provisions which relieve a fiduciary from liability for breach of the fiduciary responsibility rules would be void and of no effect except that the fiduciary's ability to allocate or delegate his responsibilities would not be affected. The bill also provides, however, that a plan may purchase insurance for itself and for its fiduciaries to cover liability or loss resulting from their acts or omissions. The bill would also permit a fiduciary to purchase insurance to cover his own liability, and permit an employer or union to purchase liability insurance for plan fiduciaries.

Limitation on actions

No action may be brought with respect to a fiduciary's breach of duty after the earlier of (1) six years after (A) the date of the last action which constituted a breach, or (B) in the case of an omission, the latest date on which the fiduciary could have cured the failure; or (2) three years after the plaintiff actually knows or had reason to know of the violation or omission (because of the filing of a report with the EBA). Additionally, where there is fraud or concealment, any such action may be brought not later than six years after the date of discovery.

2. S. 2106

Overview

S. 2106, like S. 2105, provides standards for plan administration, fiduciary duties, and prohibited transactions. Unlike S. 2105, however, it is the Secretary of Labor, rather than the EBA, who would be authorized to administer these provisions.

Plan administration

The provisions of the bill affecting plan administration are identical to those contained in S. 2105, except that this bill refers to fiduciary functions rather than duties and specifically defines fiduciary functions as any duty, obligation, power, authority, responsibility, right, privilege, activity, or program.

Special asset rules

The provisions of the bill defining plan assets are identical to those contained in S. 2105. The overall limitation with respect to acquisition of qualifying employer securities, other qualifying employer obligations, and qualifying employer real property, however, is five percent of plan assets (rather than 10 percent, as in S. 2105).

Fiduciary functions

The provisions of S. 2106 dealing with fiduciary functions differ from those of S. 2105 in the following respects:

(1) Under S. 2106, each fiduciary is made explicitly liable for breaches by any cofiduciary if the fiduciary participates in, or conceals an act or omission of the cofiduciary; if the fiduciary, by his own failure to act for the exclusive benefit of plan participants helps to create the cofiduciary's breach; or if such fiduciary has knowledge of a breach by a cofiduciary and fails to make reasonable efforts to correct the breach.

In addition, although S. 2106 permits allocation of fiduciary duties, each fiduciary who allocates or delegates duties is explicitly made liable for any act or omission by the person allocated or delegated the duty if the fiduciary failed to act in a manner consistent with his fiduciary duties with respect to the actual allocation or designation, as well as the implementation or continuation of the allocation or designation. (Under S. 2105, the general requirement that a fiduciary act for the exclusive benefit of plan participants governs cofiduciary liability with respect to allocated duties.)

(2) Although S. 2106, like S. 2105, permits a plan to provide insurance for plan fiduciaries, S. 2106 would permit a plan to purchase such insurance only if the insurance permits recourse by the insurer against the fiduciary in case of a breach of fiduciary responsibility.

Prohibited transactions

The provisions of S. 2106 regarding administrative and statutory exceptions from the prohibited transaction rules are identical to those contained in S. 2105 (although administered by the Secretary of Labor rather the EBA). However, the definition of prohibited transactions in S. 2106 is broader. In addition to defining the self-dealing transactions of S. 2105 as prohibited transactions, the bill prohibits plan fiduciaries and parties in interest from engaging in additional specific transactions. Those transactions include: (a) the direct or indirect sale, exchange, or leasing of any property from the plan to a party in interest for less than adequate consideration (or from a party in interest to a plan for more than adequate consideration); (b) the direct or indirect lending of money or other extension of credit from a plan to a party in interest without the receipt of adequate security and a reasonable rate of interest (or from a party in interest to a plan with the provision of excessive security or unreasonable interest); (c) the direct or indirect furnishing of goods or services from a plan to a party in interest to a plan for more than adequate consideration); (d) transfer to, or use by or for the benefit of a party in interest, of any plan assets for less than adequate consideration; and (e) the acquisition of any employer security, employer real property, or employer loans in violation of the five-percent limit on qualifying securities, etc.

Effective Date

These provisions of the bills would be effective at the beginning of the second calendar year following the date of the submission of the report by the Advisory Council on Government Plans. (See D. Administration and Enforcement, Explanation of Provisions—1. S. 2105, "In general.")

D. Administration and Enforcement

Explanation of Provisions

1. S. 2105

In general

Responsibility for administering the provisions of the bill would be assigned to the Employee Benefit Administration (EBA), a new Federal agency established by the bill. The EBA would be empowered to prescribe regulations, conduct investigations, and enforce the bill's provisions by civil actions against fiduciaries, plan administrators, and others.

Under the bill, the EBA and other specified persons may bring actions to collect penalties assessed by the EBA or to otherwise enforce the bill's provisions. A penalty is imposed for a failure to file a required form with the EBA and a plan administrator could be liable for a court-imposed penalty for failing to provide requested information to a plan participant or other person entitled to the information under the bill.

Exclusive Federal court jurisdiction is provided for violations of the bill's fiduciary standards. Concurrent State and Federal jurisdiction is generally retained for other civil actions. If an individual plaintiff prevails in a civil action, the bill requires that the court award attorney's fees, unless certain requirements are met.

In addition, the bill would establish an Advisory Council on Government Plans. The Council is to establish voluntary guidelines for public employee pension benefit plans with respect to funding and vesting, and is directed to act in cooperation with affected employees, employers, employee organizations, and administrators.

Request for information

If the administrator of a public employee pension benefit plan fails or refuses to comply with a request for information to which (1) a plan participant, (2) a beneficiary of a plan participant, (3) an employee organization representing employees covered by the plan, or (4) a resident of State is entitled under the bill, then the person requesting the information could enforce the request by civil action.

In addition, where a plan administrator fails or refuses to comply with a request for information by mailing the requested information within 60 days, the court could find the plan administrator personally liable to the person making the request in an amount up to $100 a day from the date of the failure or refusal, or may order other appropriate relief. However, a plan administrator would not be personally liable for a failure or refusal to provide requested information, if the failure or refusal resulted from matters beyond the administrator's control.

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Civil actions

The EBA or the attorney general of a State in which a public employee pension benefit plan is established could bring a civil action to collect a civil penalty or to recover from a fiduciary who breaches any of the duties imposed upon fiduciaries by the bill. The EBA or a State attorney general could also bring a civil action to enjoin an act or practice which violates a provision of the bill, or may seek other relief to redress the violation or to enforce the provision.

Plan participants, beneficiaries, and fiduciaries could also seek recovery from a plan fiduciary or otherwise enforce the bill's provisions by civil action. The EBA would have the right to intervene in any such action, or in any action brought by a State attorney general under the bill.

The bill provides that a public employee pension benefit plan may sue and be sued as a person. Any money judgment under the bill against a plan would be enforceable only against the plan as an entity, and not against any other person unless that person's liability is established in his or her individual capacity. In addition, the bill includes rules under which if a plan's summary plan description fails to designate an agent for service of legal process, service may be made upon the EBA. The agency would then be required to notify the plan administrator or any trustee of the pending action within 15 days after being served.

Failure to file a required form

In the case of a failure to file a required form with the EBA (for example, the annual report of a public employee pension benefit plan) on the date and in the manner prescribed, the person failing to file the form (in the case of the annual report, the plan administrator) would be liable for $10 for each day during which the failure to file continues. However, the total amount imposed for a failure to file could not exceed $5,000. The date on which a form would be required to be filed is to be determined without regard to any extension of time for filing, and a filing which is incomplete in any material respect could be considered a failure to file.

The penalty for a failure to file would be payable upon notice and demand by the EBA, and the EBA or the attorney general of a State in which the plan is established may bring a civil action to collect the penalty.

Information used for commercial solicitations

Under the bill, information filed with the EBA with respect to a public employee pension benefit plan could be provided to the public in computer-compatible form only after the person receiving the information declares that the information will not be used for commercial solicitations or similar purposes. Any person who files the required statement but uses the information for commercial purposes would be subject to a civil penalty not to exceed $5,000. The penalty is to be assessed by the EBA, and the EBA or the attorney general of a State in which the plan is established may bring a civil action to collect the penalty.

Prohibited transactions

The bill establishes a "two-tier" penalty system for prohibited transactions. If a party in interest with respect to a public employee pension benefit plan engages in a transaction with respect to the plan which is prohibited by the bill, the party in interest would be liable for an initial penalty not to exceed five percent of the amount involved. Generally, the amount involved in a prohibited transaction would be the amount of money or the fair market value of other property which is involved in the transaction. If the transaction were not corrected (in such matter and within such period as the EBA prescribes by regulation), the penalty could be increased to not more than 100 percent of the amount involved.

Under the bill, correcting a prohibited transaction would require undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than it would have been in, if the party in interest had acted in accordance with the bill's fiduciary standards.

The penalty imposed upon a party in interest with respect to a prohibited transaction could be assessed by the EBA or by the attorney general of a State in which the plan is established. The EBA or the attorney general of the State could bring a civil action to collect the penalty.

Civil actions by a State attorney general

Notice to the EBA would generally be required before the attorney general of a State brings a civil action to collect a penalty or to otherwise enforce a provision of the bill. The attorney general may proceed with the suit only if the EBA does not, within 45 days after notice, indicate its intention to bring the action. However, no notice to the EBA would be required, and the attorney general could proceed without awaiting the agency's action, if the suit is brought under the provisions of a State law which is applied (pursuant to the governor's certification) in lieu of a corresponding provision of the bill.

Federal and State court jurisdiction

Under the bill, generally any civil action brought to collect a penalty, or to otherwise enforce a provision of the bill, could be brought either in a State court or a Federal district court. However, a civil action brought under the bill's fiduciary standards could be heard only in a Federal district court. Federal district courts would have jurisdiction of actions under the bill without regard to the amount in controversy or the citizenship of the parties.

Any action to review an order of the EBA, or to restrain or compel action by the agency, could be brought in a Federal district court where the EBA has its principal office, or in the Federal district court for the District of Columbia.

Attorney's fees

In any case in which a plaintiff plan participant, beneficiary or fiduciary prevails or substantially prevails in an action brought under a provision of the bill, the court generally would be required to award the plaintiff reasonable attorney's fees. However, an award of attorney's fees would not be required if the court determines that the defendant acted in good faith and that the awarding of such fees would not further the purposes of the bill. In addition, the bill provides that a court could, in its discretion, award reasonable attorney's fees to a defendant who prevails or substantially prevails in an action brought under a provision of the bill.

Under these same rules, attorney's fees are to be awarded in cases brought under State or local law, if (pursuant to the governor's certification) State law is applied in lieu of applying a provision of the bill.

Effect upon State laws

The laws of State or local governments otherwise applicable with respect to public employee pension benefit plans would in every case be superseded to the extent of the bill provisions relating to (1) the management of plan assets, (2) fiduciary duties, (3) prohibited transactions, and (4) acquisitions of employer securities or employer real estate. The bill's remaining provisions would also supersede the otherwise applicable laws of State or local governments, except for those State laws which are to be applied (pursuant to the governor's certification) in lieu of a provision of the bill.

The provisions of the bill would not, however, relieve any person from any State law regulating insurance, banking or securities, and would not supersede any generally applicable criminal law of a State.

If a State or local law is applied (pursuant to a governor's certification) in lieu of applying a provision of the bill, the EBA generally could act to enforce the State law by civil action in a court of the State or in a Federal district court. In addition, in appropriate cases the EBA could assess civil penalties provided under the bill for violations of such a State or local law. Also, plan participants, beneficiaries, and fiduciaries could by civil action in a State court or Federal district court seek to enforce the provisions of such a State or local law, generally on the same basis as they could bring such an action to enforce a provision of the bill.

Interference with protected rights

It would be unlawful to interfere with the attainment of any rights to which a plan participant or beneficiary may become entitled under the bill, or to fire, fine, suspend, or otherwise discipline or discriminate against any participant or beneficiary for exercising any rights to which he or she would be entitled under the bill. A plan participant or beneficiary could bring a civil action against any person who interfered with his or her rights which are protected under the bill.

Advisory Council on Government Plans

The bill would require that an Advisory Council on Government Plans be established. The Council would consist of 11 members appointed by the President, generally for three-year terms. Not more than six members could be affiliated with the same political party, and the members would be representative of the employees, employee organizations, employers, and general public having a direct interest in public employee pension benefit plans.

Within one year after appointment of the Council's initial 11 members (the appointments would be required to be made within 120 days after the bill's enactment), the Council would be required to submit to the President and the Congress a report of its recommendations for implementing the bill's provisions. The Council could also recommend additional legislation.

The Council would be empowered to establish voluntary guidelines for public employee pension benefit plans with respect to matters for which requirements are not established by the bill (*e.g.*, vesting or funding). In addition, the Council would advise the EBA's Board of Directors with respect to carrying out the agency's functions with respect to public employee pension benefit plans.

2. S. 2106

The administration and enforcement provisions in S. 2106 (title III of the bill) generally parallel those of S. 2105. However, S. 2106 does not provide for the establishment of the EBA as an independent Federal agency. Accordingly, under S. 2106 the Secretary of Labor would be responsible for administering and enforcing the bill's provisions relating to public employee pension benefit plans.

In addition, under S. 2106 the law of a State or local government would be applied in lieu of applying a provision of the bill upon certification by the Secretary of Labor, rather than by the governor of the State.

Effective Dates

The provisions authorizing the creation and administration of the Advisory Council on Governmental Plans would be effective as of enactment. The provisions (under S. 2105) authorizing the EBA to issue regulations would be effective on the date the Council submits its advisory report. The remaining provisions would be effective at the beginning of the second calendar year following the date of the submission of the report by the Advisory Council on Governmental Plans.

E. Tax Qualification of Government Plans

Present Law

Under present law, a funded pension plan, including a governmental plan,[1] is a qualified plan if it meets certain requirements of the Internal Revenue Code. Also, a trust forming a part of a qualified pension plan is exempt from tax as a qualified trust if (1) employer contributions to the trust are made for the purpose of distributing the corpus and income to employees and their beneficiaries, and (2) under the trust instruments it is impossible for any part of the trust corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of employees before the liabilities to employees and their beneficiaries are satisfied. In addition to other tax-qualification requirements, the plan must not discriminate in coverage or in contributions or benefits in favor of employees who are shareholders, officers or highly compensated. Also, contributions or benefits must not exceed specified limits.

The Internal Revenue Service has announced that issues concerning prohibited discrimination in coverage or in contributions or benefits under government plans will not be raised by the Service until a review of the antidiscrimination rules is completed.[2] The Service announced that it is reconsidering the application of the antidiscrimination rules to plans covering elected and appointed officials of State and local governments. Pending completion of its review, the Service will resolve any issue under the rules in favor of a government plan's retaining its tax-qualified status.

Under present law, a trust forming a part of a government plan is not exempt from tax if the trust engages in any of the prohibited transactions provided by the Code.

Explanation of Provisions

1. S. 2105

A trust forming part of a public employee pension benefit plan which meets the requirements of the bill would be treated as a tax-qualified trust for all purposes of the Internal Revenue Code. It is intended if a trust is treated as tax-qualified, plan of which the trust is a part would also be treated as tax-qualified. Accordingly, the Code's tax-qualification rules otherwise applicable with respect to government and other funded pension plans, including those prohibiting discrimination and limiting contributions and benefits, would not apply.

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[1] A government plan is a plan established and maintained for its employees by the Government of the United States, by any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

[2] I.R.S. News Release IR-1869, August 10, 1977.

Benefits paid from a trust under a public employee pension benefit plan which meets the requirements of the bill would be entitled to the favorable tax treatment accorded benefits paid under tax-qualified plans. Therefore, benefits distributed as a lump sum distribution would be accorded special 10-year forward income averaging treatment, or could be rolled over, tax-free, to another qualified plan (whether of a private employer or another public employer) or to an individual retirement account, annuity or bond (IRA). Also, certain estate tax and gift tax exclusions would apply.

The bill also would add a new provision to the Code which would exempt from tax a trust forming a part of a public employee pension benefit plan which satisfies the bill's requirements. In the case of a trust exempt from tax under the new provision, the prohibited transaction rules of the Code would not apply.

Under the bill, the EBA would determine whether a public employee pension benefit plan satisfies the requirements of the bill, and whether a related trust is exempt from tax. The EBA would inform the Internal Revenue Service of its determination.

2. S. 2106

S. 2106 does not provide for the establishment of the Employee Benefit Administration (EBA). In addition, present-law rules relating to the tax qualification of governmental plans and the tax exemption of related trusts would continue to apply. Responsibility for administering the rules would remain with the Secretary of the Treasury.

Effective Date

These provisions of the bills would be effective at the beginning of the second calendar year following the date of the submission of the report by the Advisory Council on Government plans.

F. Employee Benefit Administration

Background and Present Law

Background

Generally, under pre-ERISA law, the Internal Revenue Service was responsible for administering provisions of the tax law providing favorable tax treatment for pension plans, profit-sharing plans, stock bonus plans, trusts under those plans, plan participants (or their beneficiaries), and employers who maintain plans.

If a pension, etc., plan qualifies under the tax law then, under ERISA and prior law, (1) a trust under the plan is generally exempt from income tax, (2) employers are generally allowed deductions (within limits) for plan contributions for the year the contributions are made, even though participants are generally not taxed on plan benefits derived from employer contributions until the benefits are distributed, (3) benefits distributed as a lump sum distribution are accorded special capital gain and 10-year income averaging treatment (and, under ERISA, may generally be "rolled over" tax-free to an individual retirement account or another qualified plan), and (4) certain estate and gift tax exclusions are provided.

Under ERISA and prior law, a trust qualifies if (1) employer contributions to the trust are made for the purpose of distributing the corpus and income of the trust to employees and their beneficiaries, (2) under the trust instrument, it is impossible for any part of the trust corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of employees at any time before its liabilities to employees and their beneficiaries are satisfied, and (3) the trust is part of a plan which qualifies under the tax law.

Under ERISA and prior law, tax-qualified pension, etc., plans are required to satisfy tests designed to assure that they cover employees in general, rather than merely those employees who are officers, share-holders, or highly compensated.

Under pre-ERISA standards a pension, etc., trust lost its income tax exemption (and the plan of which it was a part generally lost qualification under the "exclusive benefit" rule) if it engaged in certain types of self-dealing transactions with anyone who was a creator of the trust or a substantial contributor to the trust, or with certain related persons, unless the transaction met an "arms's-length" test. ERISA provides a list of specific prohibitions, violations of which result in sanctions against the self-dealers rather than against the trusts or plans.

Under ERISA and prior law, trusts under qualified pension, etc., plans are subject to the tax imposed on unrelated business taxable income.

Under the tax provisions of ERISA and prior law, a plan covering an owner-employee [1] (an H.R. 10, or Keogh, plan) is required to meet special standards relating, for example, to the group of employees covered by the plan, pre-retirement vesting, plan fiduciaries, and the time benefits are distributed. Contributions on behalf of any self-employed individual are limited in terms of the individual's net earnings from self-employment, as defined for purposes of the tax on self-employment income with certain modifications.

Under pre-ERISA law, an employee covered by a pension, etc., plan which did not qualify under the tax law could not compel compliance with the qualification standards of the tax law—the employee's rights under the plan were determined under local law on the basis of plan provisions. Noncompliance with the tax standards resulted in loss or denial of the plan's tax qualification (and a loss or denial of the tax exemption for a trust forming a part of the plan).

Under pre-ERISA law, the Welfare and Pension Plans Disclosure Act (WPPDA) required reporting and disclosure by administrators of both welfare and pension, etc., plans. However, the WPPDA exempted any plan covering fewer than 26 participants and plans administered by tax-exempt fraternal benefit societies or tax-exempt charitable, educational, religious, or civic organizations.

In addition to filing with the Department of Labor, under the WPPDA plan administrators had to make copies of filings available for inspection by any participant or beneficiary at the plan's principal office and, upon written request by a participant or beneficiary, furnish a copy of the plan description and an adequate summary of the latest annual report.

Pension, etc., trusts under ERISA

In general

Generally, ERISA preserved the plan and trust qualification standards prescribed by prior law, established additional qualification standards, and provided minimum standards for pension, etc., plans which, if violated could result in tax sanctions as well as non-tax civil and criminal sanctions and injunctive relief to compel compliance. Also, ERISA preempted the regulation of most private pension, etc., and welfare plans by the States.

Reorganization Plan No. 4

Responsibility for administering and enforcing the provisions of ERISA is generally assigned to the Department of the Treasury and the Department of Labor.[2] Under ERISA, both Departments have authority to issue regulations, rulings, and opinions, and in some cases grant variances and waivers from ERISA standards. This shared jurisdiction under ERISA was the subject of Reorgani-

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[1] An owner-employee is one who owns a trade or business as a sole proprietor or is a partner who owns more than a 10-percent interest in a partnership which operates a trade or business.

[2] Responsibility for administering the pension plan termination insurance provisions of ERISA is assigned to the Pension Benefit Guaranty Corporation, a corporation within the Department of Labor. The Joint Board for the enrollment of actuaries establishes standards and qualifications for enrolled actuaries. The United States Tax Court has jurisdiction to issue declaratory judgments in some cases with respect to the qualified status of pension, etc., plans.

zation Plan No. 4 of 1978.[3] The plan largely eliminates the overlapping authority of the Department of the Treasury and the Department of Labor to promulgate regulations, rulings and opinions, or to grant variances or waivers. However, both Departments retain their separate enforcement powers. Thus, the Reorganization Plan continues the Treasury's authority to audit plans and levy tax penalties for any deviation from the Code's standards. The plan also continues the authority of the Department of Labor to enforce ERISA standards by civil action against plans and fiduciaries.

Under the Reorganization Plan, the Treasury generally has authority for the minimum standards of ERISA and prior law. Thus, it is generally the responsibility of the Internal Revenue Service to issue regulations, rulings or opinions, or grant variances or waivers, with respect to funding, plan participation, and vesting and accrual of benefit rights. The Department of Labor generally is responsible for the administration of ERISA's reporting, disclosure, and fiduciary standards and prohibited transaction rules.

Minimum age and service standards

Under the minimum age and service standards of ERISA, a pension, etc., plan generally cannot exclude an employee from plan participation on the basis of age or length of service if the employee has attained age 25 and completed one year of service. Generally, a year of service consists of 1,000 hours of service within a designated 12-month period.

The minimum age and service standards are tax-qualification standards for plans; accordingly, they are administered by the Internal Revenue Service. The non-Code provisions of ERISA also require compliance with these standards by qualified and most nonqualified pension, etc., plans; accordingly, the minimum age and service standards are also enforced by the Labor Department.

Coverage standards

Since 1942, the tax law has explicitly required that qualified plans cover employees in general rather than merely an employer's key employees. A plan satisfies the coverage rule if (1) it benefits a classification of employees that does not discriminate in favor of employees who are officers, shareholders, or highly compensated, or (2) the plan benefits a prescribed percentage of the employees.

In applying the percentage rule under ERISA, however, only those employees who have satisfied the plan's minimum age and service requirements are taken into account. In addition, in applying either the classification or percentage tests under ERISA, em-

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[3] The Reorganization Act of 1977 (Public Law 95-17) extended for three years the authority of the President to submit plans to Congress proposing the reorganization of agencies in the Executive Branch. Under this Act, a reorganization plan takes effect 60 days after transmittal to the Congress unless either House of Congress passes an unfavorable resolution.

The intent of the Reorganization Act is to give the President the ability to reorganize the means by which the Executive Branch administers the law, not the substantive content of the programs it administers.

ployees covered by an agreement which the Labor Department finds to be a collective bargaining agreement may be excluded from consideration if the Internal Revenue Service finds that retirement benefits were the subject of good faith bargaining.[4]

Neither the minimum age and service standard nor the coverage standard applies to a governmental plan, a church plan, a plan established by a tax-exempt society, order, or association (described in sec. 501(c) (8) or (9) or certain plans not providing for employer contributions. In addition, the nontax minimum age and service standards do not apply to certain tax-exempt pension trusts under plans funded solely by employee contributions. Plans exempted from the ERISA minimum age and service standards and coverage standards are required to meet the pre-ERISA coverage standards of the tax law in order to be tax-qualified.

Vesting standards—percentage schedules

ERISA established three alternate vesting schedules under which the nonforfeitable percentage of an employee's benefit derived from employer contributions [5] depends, in whole or in part, upon the number of years of service the employee has completed. As under the minimum service standard, a year of service generally consists of at least 1,000 hours of service within a designated 12-month period. In addition, the Internal Revenue Service may require more rapid vesting, in certain circumstances, in order to prevent discrimination by a qualified plan in favor of employees who are officers, shareholders, or highly compensated.

Generally, administration under the vesting standards follows the same pattern as that under the minimum age and service standards. Accordingly, the authority to prescribe regulations under the vesting standards is generally assigned to the Treasury Department, and the authority to define an hour of service by regulation is assigned to the Labor Department. In addition, the Labor Department has exclusive authority to prescribe regulations under rules permitting a suspension of benefit payments where a former employee is reemployed.

The vesting standards are administered by the Internal Revenue Service in connection with the qualification of a plan or trust under the tax laws. The vesting standards (other then the rules relating to prohibited discrimination) are also a part of the non-Code law enforced by the Labor Department. Under the non-Code law, the vesting standards apply to qualified and most nonqualified plans.

Vesting standards—accrued benefit standards

In addition to providing minimum standards for the nonforfeitable percentage of an employee's benefit accrued under a plan, ERISA provides minimum standards for the accrued benefit to which that percentage is applied. The rate at which an employee

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[4] Other exclusions are provided (1) in the case of plans established or maintained pursuant to collective bargaining agreements (determined by the Labor Department) between airline pilots and employers, and (2) for nonresident alien employees who receive no earned income (defined by sec. 911(b)) from the employer which is income from sources within the United States (defined by sec.861(a)(3)).

[5] All benefits derived from employee contributions are required to be nonforfeitable.

accrues benefits under a defined benefit plan[6] is tested, under the accrued benefit standards of ERISA, on the basis of the number of years the employee has been a plan participant.

Generally, authority to prescribe regulations under the accrued benefit standards is assigned to the Treasury Department. Enforcement authority is assigned in the same manner as under the vesting standards (the rules enforced by the Labor Department generally apply to qualified and to most nonqualified plans).

Funding standards

Under ERISA, pension plans are required to satisfy minimum funding standards.[7]

Amounts required to be contributed to a qualified plan under the funding standards are generally deductible. Authority to prescribe regulations under the funding standards is generally assigned to the Treasury Department. Under Reorganization Plan No. 4, the Treasury Department also prescribes the rules under which retroactive amendments may be approved or amortization periods may be extended.

Under the Internal Revenue Code, the funding standards are enforced by application of an excise tax on funding deficiencies. Generally, failure to satisfy the funding standards does not result in the disqualification of a pension plan.[8] The funding standards are also a part of the non-Code law enforced by the Department of Labor (the non-Code rules apply to qualified and most nonqualified plans).

Limits on benefits and contributions

In order to limit the extent to which individuals can use tax-favored arrangements to provide for retirement, the Code provides overall limits on benefits and contributions under qualified pension, etc., plans, tax-sheltered annuities, simplified employee pensions, or any combination of these arrangements. The limitation for an individual under a tax-favored retirement arrangement is based, in part, upon the individual's compensation. In the case of a self-employed individual, the limitations are generally based upon net earnings from self-employment. Special limitations apply to employee stock ownership plans (ESOPs). Under the limitation rules, benefits and contributions for an individual under plans of related employers are aggregated.

No equivalent rules are provided under the non-Code provisions of ERISA.

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[6] Generally, a defined benefit plan provides a specified benefit level (e.g., as under the Federal civil service pension plan). Defined contribution plans, in contrast, are plans under which separate accounts are maintained for plan contributions allocated to each employee, and an employee's accrued benefit depends solely upon the balance of his or her separate account (e.g., as in a profit-sharing plan).

[7] The standards apply to defined benefit pension plans because those plans promise a specified benefit (for which funding is required), and to pension plans which promise a fixed or determinable contribution rate. The Internal Revenue Service may waive the standard for up to 5 out of 15 years, but the waived contributions must be made up in subsequent years.

[8] Church plans which have not elected to be covered by ERISA and governmental plans are not subject to the ERISA funding standard. Accordingly, they remain subject to prior law under which a plan does not qualify unless it provides full vesting of benefits (to the extent the benefits are funded) in the event of a complete discontinuance of contributions.

Plans for self-employed individuals and shareholder-employees

The Code permits a self-employed individual who operates a trade or business to enjoy the benefits of a tax-qualified plan if the plan meets special additional standards. In addition, contributions to a defined contribution plan on behalf of a self-employed individual are limited to the lesser of $15,000 or 15 percent of the individual's net earnings from self-employment. Under rules applicable to electing small business corporations (subchapter S corporations), if contributions on behalf of a shareholder-employee [9] exceed the $15,000/15-percent limit under a defined contribution plan, the excess is taxed to the shareholder-employee. The Code also provides for defined benefit H.R. 10 plans and subchapter S plans. In addition, H.R. 10 plans and plans of subchapter S corporations are subject to the overall limits on benefits and contributions applicable to other qualified plans.

No equivalent rules are provided under the non-Code provisions of ERISA.

Individual retirement accounts (IRAs) etc.

Within limitations, the Code allows a deduction for an individual's contributions to an individual retirement account (IRA). The deduction is not to exceed the lesser of (1) 100 percent of the individual's compensation includible in gross income (including self-employment income), or (2) $2,000 ($2,250 in the case of certain IRAs covering an individual and spouse).

A lump sum distribution from a qualified plan can be "rolled over" tax-free to an IRA. If an individual engages in prohibited self-dealing with an IRA, the account is disqualified and amounts held in the account are taxed to the individual.

The Code also allows plan participants a deduction for qualified voluntary employee contributions to a qualified plan, government plan, or tax-sheltered annuity program. The deduction allowed an individual for the contributions is in lieu of the deduction allowed for IRA contributions, and is generally subject to the same limitations.

No equivalent rules are provided under the non-Code provisions of ERISA.

Life insurance companies

The tax law provides special rules under which qualified pension, etc., plan assets (and related income, expense, gain, and loss) invested in annuity contracts issued by a life insurance company (or in the separate asset account of a life insurance company) are accorded similar tax treatment to that provided for assets held in a tax-exempt trust under a qualified plan (subchapter L).

General fiduciary standards; exclusive benefit of employees

The general fiduciary standards contained in the non-Code provisions of ERISA and the exclusive benefit rule of the Code regulate

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[9] A shareholder-employee is an officer or employee who owns (or is considered to own under sec. 318(a)(1)) more than 5 percent of the stock of a subchapter S corporation.

the activities of fiduciaries and other persons involved in the administration of employee benefit plans. Under the non-Code standards of ERISA, each fiduciary[10] of an employee benefit plan must act solely in the interests of the plan's participants and beneficiaries, and must act exclusively to provide benefits to the participants and beneficiaries or to pay reasonable plan administrative costs. Under the non-Code standards, a fiduciary must exercise the care, skill, prudence, and diligence under the prevailing circumstances that a prudent man acting in a like capacity and familiar with such matters would use in conducting a similar enterprise. This "prudent man rule" applies (1) specifically to the investment of plan assets, and (2) to all other aspects of plan administration. The Act also prescribes the manner in which fiduciary responsibilities may be allocated and delegated among those persons involved in a plan's administration and the extent to which those responsibilities may be allocated and delegated.

Under the Code standards of ERISA, a qualified pension, etc., plan must be for the exclusive benefit of the employees or their beneficiaries. Accordingly, plan assets generally may not inure to the benefit of the employer before the plan's liabilities to employees and their beneficiaries are satisfied. To the extent that a fiduciary complies with the prudent man rule of the non-Code standards under ERISA, the fiduciary will be deemed to have complied with the prudent man aspects of the exclusive benefit rule of the tax standards of ERISA.

Under the non-Code standards of ERISA, the transfer or distribution of the assets of an employee welfare benefit plan upon termination of the plan is to be in accordance with the terms of the plan except as otherwise prescribed by regulations of the Secretary of Labor. Normally, the terms of the plan govern such a distribution or transfer of assets, except to the extent that implementation of the terms of the plan would unduly impair the accrued benefits of the plan participants or would not be in their best interests.

Also, under the non-Code standards of ERISA, on termination of a defined benefit pension plan to which the plan termination insurance provisions do not apply, the assets of the plan are to be allocated in accordance with the plan termination insurance provisions of ERISA governing allocation of assets except as otherwise provided in regulations prescribed by the Secretary of Labor.

The non-Code fiduciary responsibility standards of ERISA generally apply to all pension, etc., plans and welfare plans of employers or organizations in, or affecting, interstate commerce.[11] They do not apply to unfunded plans designed to provide deferral of compensation primarily for a select group of management or highly compensated employees, or to unfunded excess benefit plans.

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[10] For purposes of ERISA, a fiduciary with respect to a plan is a person who (1) exercises discretionary authority or control over management of the plan or any authority over management or disposition of its assets, (2) renders investment advice for a fee with respect to money or property of the plan or has authority or responsibility to do so, or (3) has discretionary authority or responsibility in the administration of the plan.

[11] There are exceptions for governmental plans, certain church plans, workmen's compensation plans, and nonresident alien plans.

Self-dealing standards

Self-dealing standards are provided both in the Code and non-Code provisions of ERISA. The Code provisions regulate self-dealing transactions involving "disqualified persons", while the nontax provisions regulate self-dealing transactions involving "parties-in-interest". These two terms have substantially similar definitions.

The self-dealing standards under the Internal Revenue Code apply to all pension, etc., plans which are (or have been) tax-qualified and to individual retirement accounts and annuities. The self-dealing standards under the non-Code provisions of ERISA apply to all plans to which the general non-Code fiduciary rules apply.

The self-dealing rules under both the Code and non-Code provisions of ERISA prohibit certain transactions between a plan and a disqualified person (or party-in-interest). Also, they prohibit use of plan assets or income for the benefit of a disqualified person (or party-in-interest).

Under the Code provisions of ERISA, a disqualified person who engages in prohibited self-dealing is subject to a two-level excise tax sanction. Initially, the disqualified person is subjected to a tax of 5 percent per year (or part thereof) of the amount involved in the act of self-dealing. A second tax of 100 percent of the amount involved is imposed if the act of self-dealing is not corrected by a specified date. These taxes are to be imposed automatically, that is, whether or not the self-dealer realizes that a violation has occurred and whether or not it can be shown that the particular violation harms the plan.

Under the non-Code provisions of ERISA, a fiduciary who knowingly engages (or should know that he engaged in) in prohibited self-dealing or otherwise breaches any of the responsibilities imposed by ERISA is personally liable to the plan for any losses it may suffer, and for any profits that the fiduciary may realize through the use of plan assets as a result of the misconduct. Also the fiduciary is subject to other appropriate sanctions as ordered by a court, including the fiduciary's removal. In addition, civil penalties (similar to the excise tax sanctions) may be imposed.

The Code and non-Code provisions of ERISA contain similar exceptions from the specifically enumerated self-dealing prohibitions. In addition to specifically enumerated exceptions to the prohibited self-dealing rules, ERISA provides for the granting of exemptions (variances).

Authority to promulgate regulations, rulings, opinions and exemptions under ERISA's fiduciary and self-dealing standards generally rests with the Secretary of Labor. The Treasury Department retains authority over those Code provisions governing employee stock ownership plans (ESOPs) and individual retirement accounts and annuities (IRAs). In addition, the Internal Revenue Service may disqualify a pension, etc., plan under the Code's exclusive benefit rule only after first consulting the Secretary of Labor.

Reporting and disclosure requirements

The Internal Revenue Code requires every employer who maintains a pension, etc., or other funded plan of deferred compensation (whether or not qualifed) to file an annual return stating such information as is required under Treasury regulations with respect to the plan's (1) qualification, (2) financial condition, and (3) operations. The Treasury may relieve an employer of the requirement of reporting information contained in other returns.

The non-Code rules of ERISA require the filing of an annual report with respect to most employee benefit plans (including welfare plans.) [12] A copy of the report must be available for inspection by participants and beneficiaries and, upon request, must be furnished to them. The non-Code provisions of ERISA list specific information generally required to be included in the annual report and give the Secretary of Labor limited authority to increase or to decrease the amount of information so required.

ERISA also requires the filing of a registration statement detailing the vested plan benefits of separated employees. The reports filed with the Internal Revenue Service and forwarded by the Service to the Social Security Administration so that retirees (or their beneficiaries) can be advised of private pension rights when application is made for social security benefits.

The non-Code provisions also require that each employee benefit plan file a summary plan description (and any material modifications or changes therein) with the labor Department. A summary annual report and a summary plan description (and any material modifications or changes therein) are required to be furnished to plan participants and beneficiaries.

The Labor Department, the Pension Benefit Guaranty Corporation, and the Internal Revenue Service follow a procedure under which a single report is filed only with the Service for each year of a plan. Under this procedure, the Service processes the reports and furnishes data to the Labor Department. The new procedure applies to pension, etc., plans and welfare plans.

Other standards

ERISA provides several other standards which are administered by the Treasury Department pursuant to Reorganization Plan No. 4. These standards apply with respect to—

(a) joint and survivor benefits,

(b) mergers and consolidations, of plans [13]

(c) assignment and alienation of plan benefits,

(d) the time that benefits commence,

(e) plan benefit reductions due to increases in social security benefits, and

(f) forfeiture of benefits upon withdrawal of employee contributions.

Civil and criminal sanctions

The Internal Revenue Code provides sanctions in the event that a pension, etc., plan is disqualified for failure to meet the standards

[12] Under the non-Code rules of ERISA, an annual report is not required to be filed with respect to a governmental plan, a church plan which does not elect to be covered by the general provisions of ERISA, a workmen's compensation plan, a nonresident alien plan, or an unfunded excess benefit plan.

[13] The board of directors of the PBGC consists of the Secretaries of Labor (Chairman), Treasury, and Commerce.

prescribed for tax qualification (e.g., participation, antidiscrimination, and vesting). Penalty excise taxes are imposed on self-dealers and those who exceed the contribution limits for IRAs and H.R. 10 plans. Penalty excise taxes are also imposed on employers who fail to meet the minimum funding standards. In addition, penalties are imposed for failure to file reports on time.

On the Labor side, fiduciaries who violate standards may be forced to make up plan losses or disgorge profits and may be removed from office. Also, parties in interest may be subject to civil penalties. ERISA also provides criminal sanctions (up to a $5,000 fine and one year imprisonment for individuals and up to a $100,000 fine for others) for willful violations of the reporting and disclosure requirements.

ERISA also authorizes suits by participants or beneficiaries to enforce their rights under the plan or under the statute, or to enjoin violations of the plan or the statute. Suits also may be brought, under specified circumstances, by fiduciaries, the Labor Department, and the Treasury Department.

ERISA makes it unlawful to retaliate against anyone for exercising rights under an employee benefit plan or the Act, or for giving information in any inquiry or proceeding under the Act. Coercive interference with the exercise of any right under an employee benefit plan or the Act may be punished by a fine of up to $10,000 and imprisonment for up to one year.

Termination insurance

ERISA provides for insurance of vested employee benefits, up to specified limits, under defined benefit pension plans, under a program administered by the Pension Benefit Guaranty Corporation (PBGC).[13] Generally, only private, tax-qualified defined benefit pension plans are covered by the insurance.

To permit the PBGC to have advance notice of situations which may lead to plan termination, ERISA requires that certain events be reported to the PBGC within 30 days after their occurrence. Among these events are—

(a) notice by the Internal Revenue Service that a plan has ceased to qualify,

(b) a determination by the Internal Revenue Service that a plan has terminated or partially terminated, and

(c) failure of a plan to meet the minimum funding standard.

In addition, if the Internal Revenue Service finds a plan in which an event has occurred which it believes indicates the plan is unsound, the Service is required to notify the PBGC of the event.

In the event of the termination of an insured single-employer plan, plan assets are allocated to plan participants in accordance with a schedule contained in ERISA, and the PBGC insures a participant's benefits (up to the limits of the insurance) to the extent the assets allocated to the participant are insufficient. The PBGC provides financial assistance to distressed multiemployer plans.

[13] The board of directors of the PBGC consists of the Secretaries of Labor (Chairman), Treasury, and Commerce.

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Tax treatment of pension, etc., plan distributions

Under the Code provisions of ERISA, the favorable income tax treatment of a lump sum distribution from a qualified pension, etc., plan is continued with modifications. In order to permit portability of benefits under a qualified pension, etc., plan, ERISA generally provides for the tax-free rollover of a lump sum distribution from one qualified plan to another (and between qualified plans and an individual retirement account, annuity, or bond). Under the Code, the tax-free rollover of an amount which does not qualify as a lump sum distribution also is permitted in some cases from a terminated qualified pension, etc., plan to another qualified pension, etc., plan or to an individual retirement account, annuity or bond. Under ERISA, as under prior law, a distribution from a qualified pension, etc., plan in a form other than a lump sum is generally taxed under the annuity rules.

The Code also provides estate tax and gift tax exclusions for amounts payable under qualified pension, etc., plans and individual retirement accounts, etc.

Explanation of Provisions

1. S. 2105

EBA established

The bill requires that the President establish, not later than two years after the bill's enactment, the Employee Benefit Administration (EBA) as an independent agency. The EBA is to be headed by a three-member board of directors consisting of an executive director and special liaison officers from the Treasury and Labor Departments. The three board members are to be appointed by the President, generally for six-year terms, subject to confirmation by the Senate. Not more than two board members could be affiliated with the same political party.

Under the bill, all policymaking and other functions of the Secretary of Labor under ERISA are transferred to the EBA. Generally all policymaking and other functions of the Secretary of the Treasury under ERISA and under those provisions of the Internal Revenue Code relating to qualified plans and employee welfare plans are also transferred to the new agency.

All officers and employees of the Department of Labor, the PBGC, and of the Department of the Treasury (including officers and employees of the Internal Revenue Service) who are primarily engaged in functions which are to be transferred to the EBA would be tranferred to the new agency. In addition, all officers and employees of the Joint Board for the Enrollment of Actuaries would be transferred to the EBA.

Transfers from the Treasury

Under the bill, overall responsibility for administering the tax laws (whether ERISA or pre-ERISA) relating to pension, profit-sharing, stock bonus, annuity, and bond purchase plans, would be transferred from the Treasury to the EBA. Thus, authority would be granted to the EBA to promulgate regulations, rulings, and opinions (and, where appropriate, to grant variances or waivers) under ERISA and the Internal Revenue Code with respect to, *inter* *alia,* the following ERISA standards: (1) minimum age and service; (2) coverage; (3) vesting; (4) accrued benefits; and (5) funding. In addition, the EBA would be granted administrative authority for those Code provisions relating to the limitation on contributions and benefits under qualified plans, and those provisions providing special rules for qualified plans benefiting self-employed individuals or shareholder-employees of subchapter S corporations.

Under the bill, upon the request of the Secretary of the Treasury, the EBA would determine the tax qualification of any pension, etc., plan under ERISA's minimum standards and the Code's other tax-qualification rules. The new agency would then notify the Internal Revenue Service of its determination.

The bill would also transfer to the EBA administrative authority for the tax- law relating to individual retirement accounts, annuities, and bonds (IRAs).

Under the bill, the EBA would also be granted authority to administer those provisions of the Internal Revenue Code relating to self-insured medical reimbursement plans maintained by employers, prepaid group legal services plans for employees, and deferred compensation plans of State and local governments. (The tax laws relating to these plans generally provide an income exclusion if certain requirements are met.) In addition, those Code provisions granting tax exemption to voluntary employees' beneficiary associations and to trusts providing supplemental unemployment compensation benefits would be administered by the EBA.

The bill would also transfer to the new agency administrative authority for the tax law relating to tax-sheltered annuity contracts purchased for employees by certain tax-exempt organizations and educational institutions.

Under the bill, if a penalty or excise tax is imposed under a provision of the Internal Revenue Code for which administrative authority is transferred to the EBA, the new agency would determine whether the penalty or tax is owed, and the amount of such penalty or tax, if any. The Secretary of the Treasury would be required to collect any penalty or excise tax certified by the EBA. However, the new agency generally could delay, reduce, or waive any penalty or excise tax imposed with respect to an employee benefit plan under the internal revenue laws.

The bill would also require the Treasury to make available to the EBA, at the agency's request, any return, document, or other item relating to any employee benefit plan or governmental plan.

Transfers from the Department of Labor

Under the bill, responsibility for administering those ERISA standards for which authority is presently assigned to the Secretary of Labor, including those relating to fiduciaries and acts of self-dealing, would be transferred from the Department of Labor to the EBA. In addition, the Department's responsibility to enforce ERISA standards by civil actions against plans and fiduciaries would be transferred to the new agency.

The bill would also transfer to the EBA responsibilities for administering the Welfare and Pension Plan Disclosure Act (WPPDA).

The bill directs that the functions of any other Federal agency be transferred to the EBA if the President determines that the transfer would further consolidate Federal administration of employee benefit plans.

2. S. 2106

S. 2106 does not provide for the establishment of the Employee Benefit Administration (EBA) as an independent Federal agency. Instead, under S. 2106 the Secretary of Labor would be responsible for administering the bill's provisions relating to public employee pension benefit plans. In addition, responsibility for administering and enforcing ERISA and those provisions of the Internal Revenue Code relating to employee benefit plans would remain, as under present law, with the Secretaries of Treasury and Labor.

Effective Dates

Under S. 2105, the transfers of administrative and enforcement responsibilities to the EBA would take effect upon the date the new Federal agency is established. Under a transitional rule, all actions taken by the Departments of Treasury and Labor, or any other agency or court, would continue in effect until superseded by action of the EBA.

The other provisions of the bills would be effective at the beginning of the second calendar year following the date of the submission of the report by the Advisory Council on Government Plans.

IV. BUDGET EFFECTS OF THE BILLS

The bills (S. 2105 and S. 2106) would have an undetermined effect on budget receipts and on budget outlays.

II

97TH CONGRESS
2D SESSION

S. 2105

To provide for pension reform for State and local public employee retirement systems, to amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 to promote more efficient and satisfactory management of the functions of the Federal Government relating to employee benefit plans and to more effectively carry out the purposes of such Act and such Code relating to such plans, and for other purposes.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 11 (legislative day, JANUARY 25), 1982

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

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A BILL

To provide for pension reform for State and local public employee retirement systems, to amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 to promote more efficient and satisfactory management of the functions of the Federal Government relating to employee benefit plans and to more effectively carry out the purposes of such Act and such Code relating to such plans, and for other purposes.

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

SHORT TITLES

SECTION 1. (a) Title I of this Act may be cited as the "Public Employee Retirement Income Security Act of 1981".

(b) Title II of this Act may be cited as the "Employee Benefit Administration Act of 1981".

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SEC. 2. The table of contents is as follows:

TABLE OF CONTENTS

TITLE I—PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY

FINDINGS AND DECLARATION OF POLICY

SEC. 1001. (a) The Congress finds as follows:

(1) The growth in the size and scope of public employee pension benefit plans has been rapid and substantial, and a large volume of the activities of such

plans is carried on by the mails and instrumentalities of interstate commerce.

(2) Many State and local governments rely heavily on Federal funds to help meet pension costs. The maintenance and growth of such plans has a substantial and growing impact on Federal revenues.

(3) Millions of employees and their families depend on these plans for their financial well-being and security, and such plans are an important factor affecting the stability of employment. The interests of participants in such plans are in the nature of property rights.

(4) The lack of adequate standards of conduct and responsibility for fiduciaries of such plans, the arbitrary and unreasonable application of rules affecting plan operations, and the inadequate safeguards of plan assets result in a denial to participants of due process and equal protection of the laws and impair the economic security of plan participants and their beneficiaries.

(5) The investment of plan assets and the distribution of plan benefits have a substantial impact on the national economy, affecting capital formation, regional growth and decline, and the markets for securities. The financial status of such plans has a direct impact on

the markets for securities of State and local governments.

(6) Many jurisdictions do not systematically fund retirement benefits accruing to their employees. Public pensions are becoming a large financial burden on State and local governments and that burden will increase in the future.

(7) Disclosure to the general public, the responsible governments, and plan participants and their dependents about the financial status and operations of such plans and the rights of plan participants is inadequate. The lack of meaningful disclosure affects the financial stability of public employee pension benefit plans and their sponsoring governments, impairs the rights of plan participants, and constitutes a serious threat to the future economic health of the Nation.

(8) Public employee pension benefit plans have a substantial impact on interstate commerce as a consequence of the interstate nature of their financial and other activities and the interstate movement of participants. The lack of meaningful financial disclosure and standards of conduct and responsibility for fiduciaries of such plans, and the failure to fully inform participants and beneficiaries of their rights substantially impede the free flow of commerce.

(9) Public employee pension benefit plans are affected with a national public interest. It is necessary and desirable in order to protect the rights of plan participants and their beneficiaries and provide for the general welfare and the free flow of commerce, that meaningful disclosure be made and standards of conduct and responsibility be provided with respect to the establishment, operation, and administration of such plans.

(b) It is therefore declared to be the policy of this title to protect the interests of participants and beneficiaries in public employee pension benefit plans and the interests of the Federal Government and the general public in the operation of such plans and to minimize the possible adverse impact of the operations of such plans on Federal revenues and expenditures and the national securities markets, by requiring the disclosure and reporting to participants and their beneficiaries, employers, employee organizations, and the general public of financial and other information about such plans, by establishing standards of conduct and responsibility for fiduciaries of public employee pension benefit plans, and by providing for appropriate remedies, sanctions, and access to the Federal courts.

DEFINITIONS

SEC. 1002. For purposes of this Act—

(1) The term "accumulated plan benefit" means—

(A) in the case of a defined benefit plan, that portion of a participant's retirement benefit that is attributable, pursuant to the terms of the plan and in accordance with regulations of the Board, to the participant's period of credited service prior to the date of determination, and

(B) in the case of an individual account plan, the balance of the participant's account on the date of determination.

(2) The term "actuarial present value" means the single amount as of a given valuation date that results from applying actuarial assumptions to an amount or series of amounts payable or receivable at various times. Such amount or amounts shall be adjusted as appropriate to reflect—

(A) expected changes from the valuation date to the date of expected payment or receipt by reason of expected salary changes, cost-of-living adjustments, or other changes; and

(B) the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment or receipt.

(3) The term "actuarial valuation method" means a procedure, using actuarial assumptions, for measuring the expected value of plan benefits and assigning such value to time periods.

(4) The term "actuarial value of assets" means the value assigned by the actuary to the assets of a plan for the purposes of an actuarial valuation performed under section 1109.

(5) The term "adequate consideration" means—

(A) in the case of a security for which there is a generally recognized market, either—

(i) the price of the security prevailing on a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934, or

(ii) if the security is not traded on such a national securities exchange, a price not less favorable to the plan than the offering price for the security as established by the current bid and asked prices quoted by persons independent of the issuer and of any party in interest; and

(B) in the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Board.

(6) The term "administrator" means—

(A) the board of trustees, retirement board, or similar person with administrative responsibilities in connection with a plan, or any other person specifically so designated in connection with any requirement of this Act by the terms of the instrument or instruments under which the plan is operated, including but not limited to the law of any State or of any political subdivision of any State;

(B) in any case in which there is no person described in subparagraph (A) in connection with the plan, the plan sponsor; and

(C) in any case in which there is no person described in subparagraph (A) in connection with the plan and a plan sponsor cannot be identified, such other person as the Board may by regulation prescribe.

(7) The term "annual actuarial value" means that part of the actuarial present value of all future benefit payments and appropriate administrative expenses assigned to each year, or other period, under the actuarial valuation method used by the plan (excluding any amortization of the unfunded supplemental actuarial value).

(8) The term "beneficiary" means a person designated by a participant, or by the terms of a public employee pension benefit plan, who is or may become entitled to a benefit thereunder.

(9) The term "Board" means the Board of Directors of the Employee Benefit Administration established under section 3001 of the Employee Retirement Income Security Act of 1974 (as amended by title II of this Act).

(10) The term "combined actuarial value" means the sum of the annual actuarial value and that portion of the unfunded supplemental actuarial value assigned, usually by an amortization process, to the current period.

(11) The term "current value" means the fair market value, if available, or, if a fair market value is not available, the fair value as determined in good faith by a trustee or a named fiduciary pursuant to the

terms of the plan and in accordance with regulations of the Board, assuming an orderly liquidation at the time of such determination.

(12) The term "defined benefit plan" means a plan other than an individual account plan; except that a plan which is not an individual account plan and which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant shall, for the purposes of paragraph (1) of this section, be treated as—

(A) an individual account plan to the extent benefits are based upon the separate account of a participant, and

(B) a defined benefit plan with respect to the remaining portion of benefits under the plan.

(13) The term "employee" means any individual employed by an employer, employer representative, or other person required to make employer contributions under the plan.

(14) The term "employee organization" means any labor union or any organization of any kind, or any agency or employee representation committee, association, group, or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers or employer representatives

concerning a public employee pension benefit plan or other matters incidental to employment relationships; or any employees' beneficiary association organized for the purpose, in whole or in part, of establishing such a plan.

(15) The term "employer" means—

(A) the government of any State or of any political subdivision of any State; and

(B) any agency or instrumentality of a State or of a political subdivision of a State.

(16) The term "employer contribution" means any contribution to a public employee pension benefit plan other than a contribution made by a participant in the plan.

(17) The term "employer representative" means—

(A) any group or association consisting, in whole or in part, of employers acting, in connection with a public employee pension benefit plan, for an employer; and

(B) any person acting, in connection with a public employee pension benefit plan, indirectly in the interest of an employer or of a group or association described in subparagraph (A).

(18) The term "enrolled actuary" means an actuary enrolled by the Joint Board for the Enrollment of Actuaries in accordance with section 3042 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1242), except that, with respect to individuals applying for enrollment during the one-year period following the date of the enactment of this Act who certify to the Joint Board, in a manner which shall be prescribed by the Joint Board, that they are applying only for the purpose of performing actuarial services with respect to plans to which this Act applies, paragraphs (1) and (2) of subsection (a) of such section 3042 shall not apply, and the standards and qualifications required by the Joint Board shall include a requirement for an appropriate period of responsible actuarial experience relating to public employee pension benefit plans. References in such section 3042 to the Employee Retirement Income Security Act of 1974 shall be construed to also refer to this Act.

(19)(A) Except as otherwise provided in subparagraphs (B) and (C), the term "fiduciary" means, in connection with a plan, any person to the extent that—

(i) such person exercises any discretionary authority or discretionary control with respect to management of such plan or exercises any authority or control with respect to management or disposition of its assets;

(ii) such person renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so; or

(iii) such person has any discretionary authority or discretionary responsibility in the administration of such plan.

Any person designated under section 1202(c)(4) is a fiduciary.

(B) If any money or other property of a plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.), such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a fiduciary, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with a public employee pension benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

(C) No director, officer, or employee of a corporation which is itself a fiduciary shall be a fiduciary soley by reason of actions taken or responsibilities assumed in the course of such individual's employment or office with such corporation: *Provided,* That such corporation assumes responsibility and liability for such actions taken or responsibilities assumed by such director, officer, or employee: *Provided further,* That in the event such corporation is unable to pay any money judgment entered against it pursuant to section 1209, then the status of such director, officer, or employee shall be determined without regard to this subparagraph.

(20) The term "individual account plan" means a plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

(21) The term "investment manager" means, in connection with a plan, any person who is a fiduciary

with respect to the plan (other than a trustee or named fiduciary)—

(A) who has the power to manage, acquire, or dispose of any asset of the plan;

(B) who is either—

(i) registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.);

(ii) a bank, as defined in that Act; or

(iii) an insurance company qualified to perform services described in subparagraph (A) under the laws of more than one State; and

(C) who has acknowledged in writing that such person is a fiduciary with respect to the plan.

(22) The term "named fiduciary" means a person who is designated a named fiduciary in accordance with section 1202(a).

(23) The term "participant" means an individual who is or may become eligible to receive a benefit of any type from a public employee pension benefit plan or whose beneficiaries may be eligible to receive any such benefit.

(24)(A) Except as provided in subparagraph (B), the term "party in interest", with respect to a public employee pension benefit plan, means—

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

(ii) a person providing services to such plan;

(iii) an employer or employer representative any of whose employees are covered by such plan;

(iv) an employee organization any of whose members are covered by such plan;

(v) a relative (as defined in paragraph (27)) of any individual described in clause (i) or (ii); and

(vi) an individual (earning 10 per centum or more of the yearly wages of the person employing the individual) employed by, or an officer or director (or an individual having powers or duties similar to those of officers or directors) of—

(I) a person described in clause (ii), (iii), or (iv), or

(II) such plan.

(B) If any money or other property of a plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a party in interest, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with a public employee pension benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

(25) The term "person" means a State, a political subdivision of a State, any agency or instrumentality of a State or a political subdivision of a State, an individual, a partnership, a joint venture, a corporation, a mutual company, a joint-stock company, a trust, an estate, an unincorporated organization, an association, or an employee organization.

(26) The term "plan sponsor" means—

(A) in the case of a plan established or maintained solely for employees of a single employer, such employer,

(B) in the case of a plan established or maintained by an employee organization, the employee organization, and

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

(27) The term "plan year" means, with respect to a plan, the calendar, policy, or fiscal year on which the records of the plan are kept.

(28) The terms "public employee pension benefit plan" and "plan" mean any plan, fund, or program which was heretofore or is hereafter established or maintained, in whole or in part, by an employer, an employer representative, or an employee organization, or by a combination thereof, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program—

(A) provides retirement income to employees, or

(B) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond,

regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan, or the method of distributing benefits from the plan.

(29) The term "relative" means a brother, sister, spouse of a brother or sister, spouse, ancestor, lineal descendant, or spouse of a lineal descendant.

(30) The term "security" has the same meaning as such term has under section 2(1) of the Securities Act of 1933 (15 U.S.C. 77b(1)).

(31) The term "separate account" means an account established or maintained by an insurance company under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such accounts without regard to other income, gains, or losses of the insurance company.

(32) The term "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, American Samoa, and Guam. The term "United States" when used in the geographic sense means the States and the Outer Continental Shelf lands defined in the Outer Continental Shelf Lands Act (43 U.S.C. 1331–1343).

(33) The term "supplemental actuarial value" means the actuarial present value of all future benefit

payments and appropriate administrative expenses under a plan reduced by the actuarial present value of all future annual actuarial values (including any participants' contributions) with respect to the participants included in the actuarial valuation of the plan.

(34) The term "unfunded supplemental actuarial value" means the excess of the supplemental actuarial value over the actuarial value of assets of a plan.

(35) The term "vested pension benefit" means an interest obtained by a participant or beneficiary in that part of an immediate or deferred benefit under a plan which—

(A) arises from the participant's service,

(B) is not conditional upon the participant's continued service for an employer or employer representative which employs one or more participants in the plan, and

(C) has not been forfeited under the terms of the plan.

COVERAGE

SEC. 1003. (a) Except as provided in subsection (b), this Act shall apply to any public employee pension benefit plan.

(b) The provisions of this Act shall not apply to—

(1) any employee benefit plan described in section 4(a) of the Employee Retirement Income Security Act

of 1974 (29 U.S.C. 1003(a)), which is not exempt under section 4(b)(1) of such Act (29 U.S.C. 1003(b)(1));

(2) any plan which is unfunded and is maintained by an employer or employer representative primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees;

(3) any severance pay plan, as defined in regulations by the Board;

(4) any agreement to the extent it is a coverage agreement entered into pursuant to section 218 of the Social Security Act (42 U.S.C. 418);

(5) any individual retirement account or an individual retirement annuity within the meaning of section 408, or a retirement bond within the meaning of section 409, of the Internal Revenue Code of 1954;

(6) any plan described in section 401(d) of such Code;

(7) any individual account plan consisting of an annuity contract described in section 403(b) of such Code;

(8) any eligible State deferred compensation plan, as defined by section 457(b) of such Code; or

(9) any plan maintained solely for the purpose of complying with applicable workers' compensation laws or disability insurance laws.

Subtitle A—Reporting and Disclosure

DUTY OF DISCLOSURE AND REPORTING

SEC. 1101. (a) Except as provided in subsection (b), each administrator shall submit a registration statement to the Board not more than one hundred and twenty days after the effective date set forth in section 1313(a). Such registration statement shall provide the name and address of the plan and its administrator, and such other information relating to the characteristics and identity of the plan as the Board considers necessary in order to determine the extent to which the provisions of this Act apply to such plan. The Board shall issue regulations to implement the provisions of this paragraph.

(b) Subsection (a) shall not apply to a plan in any case in which the registration statement required under section 6057 of the Internal Revenue Code of 1954 with respect to the plan has been filed by its administrator during the two-year period ending on the last day of the one-hundred-and-twenty-day period described in such subsection and such registration statement continues to accurately reflect the status of the plan.

EXEMPTION FOR PLANS MEETING MINIMUM STANDARDS UNDER STATE LAW

SEC. 1102. Any requirement of this subtitle or section 1212, 1301(b), or 1306 shall not apply to a plan to the extent that the Governor (or equivalent official) of a State certifies to the Board, in accordance with regulations which shall be prescribed by the Board, that—

(1) the law of the State applies a requirement to such plan substantially equivalent to such requirement of this subtitle or such section;

(2) there is adequate provision for State administration of such requirement of such State; and

(3) the State has adequate means to collect the annual reports required under its law and will collect such reports and provide them to the Board.

SUMMARY PLAN DESCRIPTION

SEC. 1103. (a)(1) The administrator of each public employee pension benefit plan shall publish a summary plan description with respect to every plan to which this Act applies. The summary plan description shall include the information required under subsection (b). The summary plan description, a summary of any material modification in the terms of the plan and any other change in the information required under subsection (b), and any updated summary plan description required under subsection (c) shall be furnished to participants, beneficiaries, and other persons in the manner and to the extent provided in section 1110.

(2) The summary plan description and any other summary description required by this title shall be written in a manner calculated to be understood by the average plan participant and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and their beneficiaries of their rights and obligations under the plan.

(b) The summary plan description shall contain the following information:

(1) the name of the plan and the type of administration;

(2) the name and address of the person designated as agent for the service of legal process, if such person is not the administrator;

(3) the name and address of the administrator;

(4) the names, titles, and addresses of any trustee or trustees (if they are persons different from the administrator);

(5) a description of the relevant provisions of any applicable collective bargaining agreement;

(6) citations to the relevant provisions of State and local law and regulations governing the establishment, operation, and administration of the plan;

(7) the plan's requirements with respect to eligibility for participation and benefits;

(8) a description of those provisions which specify the conditions under which pension benefits under the plan become vested pension benefits;

(9) the circumstances which may result in disqualification, ineligibility, or denial or loss of benefits;

(10) the source of financing of the plan and the identity of any organization through which benefits are provided;

(11) the date of the end of the plan year and whether the records of the plan are kept on a calendar, policy, or fiscal year basis; and

(12) the procedures to be followed in presenting claims for benefits under the plan and the remedies available under the plan for the redress of claims which are denied in whole or in part (including procedures required under section 1114 of this Act).

(c) The summary plan description shall include a statement of the rights of participants and beneficiaries under this Act.

(d)(1) The administrator of each plan shall publish a summary description of any material modification in the terms of the plan and any other change in the information required under subsection (b) not later than two hundred and ten days after the end of the plan year in which the modification or other change is adopted, or within such time as the Board may prescribe by regulation.

(2)(A) Except as provided in subparagraph (B), in any case in which a plan is amended, the administrator of the plan shall update its summary plan description within ten years after the date of adoption of the amendment by integrating the amendment into such description.

(B) In any case in which a plan amendment referred to in subparagraph (A) has the effect of curtailing or reducing benefits or further restricting entitlement thereto, the administrator of the plan shall update the summary plan description by integrating the amendment into such description within five years after the earlier of the date of adoption or the effective date of the amendment.

(3) The summary of modifications and changes and the updated summary plan description required by this subsection shall be distributed to participants and beneficiaries as provided in section 1110.

ANNUAL REPORT

SEC. 1104. (a)(1) The administrator of each public employee pension benefit plan to which this Act applies shall publish an annual report for each plan year. Such report shall include the information and statements described in sections 1105 and 1106 and, as applicable, sections 1107 and 1108.

(2) The administrator shall file the annual report with the Board in accordance with section 1112 and shall make available and furnish the report to participants, beneficiaries, and other persons as provided in section 1110.

(3) In addition to the information otherwise required by this title in the annual report, the administrator may include in the annual report a statement or statements relating to any matter contained in the annual report.

(b)(1) If some or all of the information necessary to enable the administrator to comply with the requirements of this title is maintained by—

(A) an insurance carrier or other organization which provides some or all of the benefits under the plan, or holds assets of the plan in a separate account,

(B) a bank or similar institution which holds some or all of the assets of the plan in a common or collective trust or a separate trust, or custodial account, or

(C) the plan sponsor,

such carrier, organization, bank, institution, or plan sponsor shall transmit and certify the accuracy of such information to the administrator within one hundred and twenty days after the end of the plan year covered by the annual report (or such other date as may be prescribed under regulations of the Board).

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(2)(A) The Board shall by regulation prescribe simplified annual reports for any plan which covers fewer than one hundred participants.

(B) Nothing contained in this subsection shall preclude the Board from revoking provisions for simplified reports for any such plan if the Board finds it necessary to do so in order to carry out the objectives of this Act.

GENERAL INFORMATION INCLUDED IN ANNUAL REPORT

SEC. 1105. The annual report shall include the following information:

(1) the name of the plan, and any change in the name of the plan;

(2) the name and address of the administrator, and any change in the name or address of the administrator;

(3) the name and address of the person designated as agent for the service of legal process, if such person is not the administrator;

(4)(A) the name and taxpayer identifying number of each participant in the plan—

(i) who in the year preceding the plan year for which such annual report is filed, separated from service covered by the plan,

(ii) who did not return to service covered by the plan by the end of the plan year for which such annual report is filed,

(iii) who is entitled to a vested pension benefit under the plan or to the return of employee contributions, and

(iv) with respect to whom benefits were not paid under the plan during the plan year for which the annual report is filed or the plan year preceding such plan year;

(B) the nature, amount, and form of any benefits to which each participant described in subparagraph (A) is entitled, including but not limited to the contributions made by such participant, if any, and interest on such contributions, if any;

(5) the name and address of each fiduciary with respect to the plan;

(6) the number of employees covered by the plan;

(7) except in the case of a person whose compensation is minimal (determined under regulations of the Board) and who performs solely ministerial duties (determined under such regulations), the name of each person (including but not limited to any consultant, broker, trustee, attorney, accountant, insurance carrier, actuary, administrator, investment manager, or custodi-

an) who received compensation directly or indirectly from the plan during the plan year for which the annual report is filed for services rendered to the plan or its participants, the amount of such compensation, the nature of such person's services to the plan or its participants, such person's relationship to each employer of the employees covered by the plan, to any employer representative of each such employer, and to any employee organization participating in the establishment or maintenance of the plan, and any other office, position, or employment such person holds with any party in interest;

(8) an explanation of the reason for any change in appointment of any consultant, broker, trustee, attorney, accountant, insurance carrier, actuary, administrator, investment manager, or custodian;

(9) a summary description of plan modifications or amendments described in paragraphs (1) and (2) of section 1103(d); and

(10) any other information which is necessary to carry out the purposes of this Act and which the Board may require regarding—

(A) a termination of the plan,

(B) a merger or consolidation by the plan with another plan or a significant change in coverage by the plan, or

(C) a withdrawal from the plan by a contributing employer or employer representative.

FINANCIAL STATEMENT INCLUDED IN ANNUAL REPORT

SEC. 1106. (a)(1) Except as provided in paragraph (3), the administrator of a plan shall engage in connection with the preparation of the plan's annual report, on behalf of all plan participants, an independent qualified public accountant. The accountant shall conduct such an examination of any financial statements of the plan, and of other books and records of the plan, as the accountant may consider necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual report by this section are presented fairly and in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards, except as provided in paragraphs (2) and (3), and shall involve such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant. The independent qualified public accountant shall also offer such accountant's opinion as to whether the separate schedules specified in subsection (b)(2) present fairly and in all material respects the information contained therein when considered in conjunction with the financial statements taken as a whole. The opinion by the independent qualified public accountant shall be made a part of the annual report. If by reason of section 1104(b)(2) a plan is required only to file a simplified annual report, the Board may modify or waive the requirements of this section.

(2) In offering an opinion under this subsection, the accountant shall rely on the correctness of any actuarial matter certified to by an enrolled actuary.

(3) The opinion required by paragraph (1) shall not be expressed as to any statements required by subsection (d) to be prepared by a bank or similar institution or insurance carrier regulated, supervised, and subject to periodic examination by a State or Federal agency if such statements are certified by the bank, similar institution, or insurance carrier as accurate and are made a part of the annual report.

(4)(A) For purposes of this subsection, the term "independent qualified public accountant" means, when used in connection with a plan—

(i) a properly constituted audit agency of a State or a political subdivision of a State which has no direct relationship ~~with the functions~~ or activities examined thereby in connection with the plan or with the business conducted by any of the fiduciaries of the plan, including the officials of the plan or any trust constituting a part of the plan; and

(ii) any other qualified public accountant who is independent, as defined in regulations which shall be prescribed by the Board.

(B) For purposes of this paragraph, the term "qualified public accountant" means—

(i) a person who is a certified public accountant, certified by a regulatory authority of a State;

(ii) a person who is a licensed public accountant, licensed by a regulatory authority of a State; or

(iii) in the case of persons who practice as accountants for plans in States in which no certification or licensing procedure for accountants exists, such a person certified by the Board as a qualified public accountant in accordance with regulations prescribed by the Board.

(b) An annual report under this title covering any plan year shall include a financial statement containing the following information:

(1) A statement of assets and liabilities as of the end of the plan year, together with a statement of changes which occurred during the plan year in net assets available for plan benefits which shall include details of revenues and expenses and other changes ag-

gregated by general source and application. In the notes to financial statements, disclosures concerning the following items shall be considered by the accountant:

(A) a description of the plan as of the end of the plan year, including any significant changes in the plan made during the plan year and the impact of such changes on benefits;

(B) the funding policy in effect during the plan year (including policy with respect to the funding of any unfunded supplemental actuarial value), and any changes in such policy during the year;

(C) a description of any significant changes in plan benefits made during the plan year;

(D) a description of material lease commitments, other commitments, and contingent liabilities undertaken during the plan year;

(E) a description of agreements and transactions entered into during the plan year with persons known to be parties in interest;

(F) a general description of any plan provision which was in effect during the plan year providing for allocation of assets upon termination of the plan;

(G) information concerning the plan's qualified status under section 401 of the Internal Revenue Code of 1954 during the plan year; and

(H) any other relevant information necessary to fully and fairly present the financial statements of such plan.

(2) The following information in separate schedules relating to the statement required under paragraph (1):

(A) a statement of the assets and liabilities of the plan as of the end of the plan year, aggregated by categories and valued at their current value, and the same data displayed in comparative form for the end of the preceding plan year;

(B) a statement of receipts and disbursements during the plan year, aggregated by general sources and applications;

(C) a schedule of—

(i) all assets held for investment purposes during the plan year, and

(ii) all assets so held as of the end of the plan year,

aggregated and identified by issuer, borrower, or lessor, or similar party to the transaction (including a notation as to whether such party is known to be a party in interest), maturity date, rate of interest, collateral, par or maturity value, cost, and current value;

(D) except with respect to any transaction which occurs in connection with assets all of which are excluded from assets of the plan under section 1208(d), a schedule of each transaction entered into during the plan year (other than the payment of benefits pursuant to the terms of the plan) involving a person known to be a party in interest, the identity of such party in interest and the relationship of such party in interest to any other party in interest to the plan, a description of each asset to which the transaction relates; the purchase or selling price in the case of a sale or purchase, the rental in the case of a lease, or the interest rate and maturity date in the case of a loan; expenses incurred in connection with the transaction; the cost of the asset, the current value of the asset as of the end of the plan year, and the net gain (or loss) on each transaction;

(E) a schedule of all loans or fixed income obligations which were in default as of the end of the plan year or were classified during the plan year as uncollectable and the following information with respect to each loan on such schedule (including a notation as to whether the parties involved are known to be parties in interest):

(i) the original principal amount of the loan,

(ii) the amount of principal and interest received during the plan year,

(iii) the unpaid balance as of the end of the plan year,

(iv) the identity and address of the obligor as of the end of the plan year,

(v) a detailed description of the loan (including date of making and maturity, interest rate, the type and value of collateral, and other material terms), and

(vi) the amount of principal and interest overdue (if any) as of the end of the plan year and an explanation thereof; and

(F) a list of all leases which were in default during the plan year or were classified during the plan year as uncollectable; and the following information with respect to each lease on such schedule (including a notation as to whether the parties involved are known to be parties in interest):

(i) the type of property leased (and, in the case of fixed assets such as land, buildings, leasehold, and so forth, the location of the property),

(ii) the identity of the lessor or lessee from or to whom the plan is leasing,

(iii) the relationship of such lessors and lessees, if any, to the plan, each employer and any employer representative connected with the plan, any employee organization connected with the plan, and any other party in interest,

(iv) the terms of the lease regarding rent, taxes, insurance, repairs, expenses, and renewal options,

(v) the date the leased property was purchased and its cost,

(vi) the date the property was leased and its approximate value at such date,

(vii) any gross rental receipts during the plan year,

(viii) any expenses paid for the leased property during the plan year,

(ix) any net receipts from the lease,

(x) the amounts in arrears as of the end of the plan year, and

(xi) a statement as to what steps have been taken to collect amounts due or otherwise remedy any default.

(c)(1)(A) A plan which meets the requirements of subparagraph (B) may elect to include as part of its annual report, in lieu of the information required to be reported under paragraph (2) of subsection (b) with respect to those assets of the plan which are held by a trust described in clause (i) of subparagraph (B)—

(i) the information required to be reported in paragraph (2) of subsection (b), but with respect to all the assets of such trust in lieu of such assets of such plan; and

(ii) in the separate statements and schedules of the annual report of the plan, information regarding the total value of the plan's participation or interest in such trust and information regarding the plan's share of net earnings attributable to its participation or interest in such trust.

(B) A plan meets the requirements of this subparagraph if—

(i) the assets of the plan are held in whole or in part in a trust which consists of the assets of two or more participating plans which are maintained by a single employer or employer representative, or by two or more employers or employer representatives each of whom is an affiliate (as defined in section 1207(b)(7)) of all other such employers or employer representatives;

(ii) the assets of such trust are held for collective investment and reinvestment; and

(iii) such single employer or group establishes such trust and procures the services of a bank or other similar institution in connection with such trust to assist such employer or group in providing the information required under this subsection.

(2) The Board may waive the filing by any plan of the information required under paragraph (1) with respect to the assets of the plan held by such trust if the trustee of the trust has filed such information in accordance with regulations prescribed by the Board.

(3) Nothing in this subsection shall relieve the administrator of a participating plan from filing the information required by paragraphs (1) and (2) of subsection (b) with regard to assets not held in a trust to which this paragraph applies.

(d)(1) If some or all of the assets of a plan or plans are held in a common or collective trust maintained by a bank or similar institution, a separate account maintained by an insurance carrier, or a separate trust maintained by a bank as trustee, the financial statement shall include the most recent annual statement of assets and liabilities of such common or collective trust, and in the case of a separate account or a separate trust, such other information as is required by the administrator in order to comply with this section.

(2) The Board may, by regulation, relieve any plan from filing a copy of a statement of assets and liabilities (or other information) described in paragraph (1) if such statement or other information is filed with the Board by a bank or similar institution or insurance carrier which maintains the common or collective trust, separate account, or separate trust.

ACTUARIAL STATEMENT INCLUDED IN ANNUAL REPORT

SEC. 1107. (a) With respect to a defined benefit plan (other than a plan having the same characteristics as an insurance contract plan described in section 301(b) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1081(b))), an annual report under this Act shall include a complete actuarial statement applicable to the plan year for which the report is filed.

(b) The administrator of a plan subject to this section shall engage, on behalf of all plan participants, an enrolled actuary who shall be responsible for the preparation of the materials comprising the actuarial statement required by this section and the performance of actuarial valuations required by section 1109. In making a certification under this section, the enrolled actuary shall rely on the correctness of any accounting matter under section 1106 with respect to which the independent qualified public accountant has expressed an opinion.

(c) The actuarial statement for a plan year shall include the following:

(1) The beginning and ending dates of the plan year, and the date of the actuarial valuation performed pursuant to section 1109 applicable to the plan year.

(2) The total amount of the contributions made by the participants and the total amount of all other contributions, including employer contributions received by the plan, for each of the following:

(A) the plan year; and

(B) each of the preceding plan years for which such information was not previously reported.

(3) The total amount of the contributions of participants and the total amount of all other contributions, including employer contributions, for the plan year which are expected to be made but which are not reported under paragraph (2) as having been made.

(4) The total estimated amount of the covered compensation with respect to active participants for the plan year.

(5) The number, as of the date of the actuarial valuation performed pursuant to section 1109 applicable to the plan year, of—

(A) active participants,

(B) terminated participants currently eligible for deferred vested pension benefits or the return of contributions made by such participants, and

(C) all other participants and beneficiaries included in the actuarial valuation performed pursuant to section 1109.

(6) The following values as of the date of the actuarial valuation performed pursuant to section 1109 applicable to the plan year:

(A) the current value of assets accumulated in the plan,

(B) the amount of accumulated mandatory contributions for active participants (including interest, if any), and

(C) the amount of accumulated voluntary contributions for active participants (including interest, if any).

The amounts in subparagraphs (B) and (C) may be combined if they are not available separately.

(7) The following information applicable to the plan year:

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(A) a complete description of the basis on which the plan is funded,

(B) if an actuarial valuation for funding purposes was performed pursuant to section 1109 during the plan year—

(i) a description of the actuarial valuation method and actuarial assumptions, and

(ii) if computed, the annual actuarial value, the combined actuarial value (including a description of the method of calculating the portion of the combined actuarial value which is based on the unfunded supplemental actuarial value), and the unfunded supplemental actuarial value, and

(C) if such an actuarial valuation for funding purposes was not performed—

(i) the period for which the most recent actuarial valuation for funding purposes was performed pursuant to section 1109, and

(ii) the frequency with which actuarial valuations for funding purposes are performed under the plan.

(8) The following actuarial values as of the date of the actuarial valuation performed pursuant to section 1109 applicable to the plan year:

(A) the actuarial present value of all future plan benefits (including, if applicable, future automatic and ad hoc benefit increases which can be reasonably anticipated) for the individuals described in subparagraphs (A) and (B) of paragraph (5);

(B) the actuarial present value of accumulated plan benefits for—

(i) vested active participants, and

(ii) nonvested active participants;

(C) the actuarial present value of the total projected plan benefits (reflecting anticipated future increases in compensation and the cost of living, if applicable) which is inclusive of the amounts in subparagraphs (A) and (B);

(D) the actuarial present value of future covered compensation for active participants; and

(E) the actuarial value of the assets of the plan.

(9) A statement by the enrolled actuary that to the best of the actuary's knowledge the report under this subsection is complete and accurate and that in the actuary's opinion the assumptions and methods utilized for purposes of paragraph (8) meet the requirements of such paragraph.

(10) Such other information as may be necessary to fully and fairly disclose the actuarial position of the plan and any other information the enrolled actuary may present.

(d)(1) The enrolled actuary shall utilize on an explicit basis such assumptions and methods as are necessary for the contents of the matters reported under subsection (c)(8) to be reasonably related to the experience of the plan and to reasonable expectations and to represent the actuary's best estimate of anticipated experience under the plan.

(2) The actuarial statement under this subsection shall include a description of the actuarial assumptions and methods used to determine the actuarial values under subsection (c)(8) (including ~~an identification~~ of benefits not included in such actuarial values) and shall disclose the impact of significant changes in the actuarial assumptions and methods, plan provisions, and other pertinent factors on the actuarial position of the plan.

(3) Together with the actuarial statement with respect to the plan as a whole, a separate actuarial statement, including such information as the Board by regulation shall find to be consistent with this subsection, shall be filed for each subpart of the plan which, as determined by the Board, in accordance with regulations of the Board—

(A) covers at least 5 per centum of the plan's active participants, and

(B) is operated as a separate plan for funding purposes, such that the assets of the subpart cannot be used for the payment of benefits to persons not covered by such subpart.

REPORT OF INSURANCE ORGANIZATION INCLUDED IN ANNUAL REPORT

SEC. 1108. (a) If some or all of the benefits under a public employee pension benefit plan are purchased from and guaranteed by an insurance company, insurance service, or other similar organization, the annual report for a plan year shall include a statement from such insurance company, service, or other similar organization covering the plan year and enumerating—

(1) the premium rate or subscription charge and the total premium or subscription charges paid to each such carrier, insurance service, or other similar organization;

(2) the total amount of premiums received, the approximate number of persons covered by each class of benefits, and the total claims paid by such company, service, or other organization;

(3) dividends or retroactive rate adjustments, commissions, and administrative service or other fees or

other specific acquisition costs paid by such company, service, or other organization;

(4) any amounts held to provide benefits after retirement; and

(5) the remainder of such premiums, and the names and addresses of the brokers, agents, or other persons to whom commissions or fees were paid, the amount paid to each, and for what purpose.

(b) If any such company, service, or other organization does not maintain separate experience records covering the specific groups it serves, the report shall include, in lieu of the information required by paragraphs (2) through (5) of subsection (a), the following:

(1) a statement as to the basis of its premium rate or subscription charge, the total amount of premiums or subscription charges received from the plan, and a copy of the financial report of the company, service, or other organization; and

(2) if such company, service, or organization incurs specific costs in connection with the acquisition or retention of any particular plan or plans, a detailed statement of such costs.

PERIODIC ACTUARIAL VALUATIONS

SEC. 1109. (a) The enrolled actuary of a public employee pension benefit plan shall make an actuarial valuation of the plan at least once every three plan years.

(b) In accordance with regulations which shall be prescribed by the Board, actuarial valuations under this section shall be made more frequently if the enrolled actuary determines—

(1) that amendments to the plan are made which significantly affect the actuarial position of the plan, or

(2) that a more frequent valuation is necessary to support the actuary's opinion under section 1107(c)(9).

INFORMATION TO BE PROVIDED TO PARTICIPANTS, BENEFICIARIES, AND OTHER PERSONS

SEC. 1110. (a)(1) The administrator of a public employee pension benefit plan shall furnish to each individual who is a participant, or is a beneficiary receiving benefits under the plan, as required by this section, a copy of the summary plan description, including all modifications and changes referred to in section 1103(d) a summary description of which has been furnished to other participants and beneficiaries—

(A) in the case of a participant, within one year and ninety days after the individual becomes a participant, or, in the case of a beneficiary, within ninety days after the individual first receives benefits, or

(B) if later, within one year and ninety days after the plan becomes subject to this title.

(2) If there is a modification or change described in section 1103(d), the administrator shall furnish a summary description of such modification or change to each participant, and to each beneficiary who is receiving benefits under the plan, whose future benefits may reasonably be expected to be affected thereby. The administrator shall furnish such summary description not later than two hundred and ten days after the end of the plan year in which the modification or change is adopted, or within such time as the Board may prescribe by regulation.

(3) Any updated summary plan description required under section 1103(d) shall be provided to each participant and each beneficiary receiving benefits under the plan whose future benefits may reasonably be expected to be affected by any plan amendment made within the period described in section 1103(d).

(b) In the case of any public employee pension benefit plan, upon written request of any—

(1) participant of the plan,

(2) beneficiary of the plan,

(3) employee organization which represents employees covered in whole or in part by the plan, or

(4) resident of any State, if—

(A) such State, any agency or instrumentality of such State, any political subdivision of such State, or any agency or instrumentality of a political subdivision of such State is an employer with respect to such plan or is one of a group or association which is an employer representative (as defined in section 1002(17)(A)) with respect to such plan, or

(B) any person is an employer representative (as defined in section 1002(17)(B)) with respect to such plan acting in the interest of any of the persons referred to in subparagraph (A),

the administrator shall furnish a copy of summary plan descriptions, annual reports, bargaining agreements, trust agreements, contracts, or other instruments under which the plan is established or operated. The administrator may make a reasonable charge to cover the cost of furnishing such copies. The Board may by regulation prescribe the maximum amount which will constitute a reasonable charge.

(c) The administrator shall make copies of the documents described in subsection (b) available for examination by any person described in subsection (b) in the principal office of the administrator and in such other places as may be necessary to make such documents available to all participants (including such places as the Board may prescribe by regulation).

REPORTING OF PARTICIPANT'S BENEFIT RIGHTS

SEC. 1111. (a) The administrator shall furnish to any plan participant or beneficiary who so requests in writing, a statement indicating, on the basis of the latest available information—

(1) the total accumulated plan benefits,

(2) the extent to which benefits are or will become vested pension benefits,

(3) if applicable, the earliest date on which such accumulated plan benefits are expected to become vested pension benefits, and

(4) the total accumulated contributions made by the participant, including interest, if any, pursuant to the terms of the plan.

(b) In no case shall a participant or beneficiary be entitled under this section to receive more than one report described in subsection (a) during any one twelve-month period. If an administrator furnishes an annual statement which contains the information described in subsection (a), the furnishing of such annual statement shall satisfy the requirements of subsection (a).

(c) The administrator shall provide to each participant in the plan—

(1) who in the year preceding the plan year for which the annual report is filed, separated from service covered by the plan,

(2) who did not return to service covered by the plan by the end of the plan year for which the annual report is filed,

(3) who is entitled to a vested pension benefit under the plan (or would be so entitled within two years) or is entitled to the return of employee contributions, and

(4) with respect to whom benefits were not paid under the plan during such plan years,

a statement setting forth the nature, amount, and form of any benefits to which such participant is entitled, including but not limited to the contributions made by such participant, if any, and the interest on such contributions, if any. Such statement shall be provided within the time prescribed for the filing of such annual report.

(d) The administrator shall furnish to any participant or beneficiary who requests—

(1) the withdrawal of contributions made by a participant,

(2) the payment of any benefit from the plan, or

(3) in accordance with the terms of the plan, an election as to the form of benefits to be made available under the provisions of the plan,

a written explanation of the effect of such withdrawal, payment, or election on the remaining plan benefits of the participant or beneficiary. Such explanation shall include a description of the various alternative forms of benefit payments, if any, which the participant may elect. No such election shall be final until thirty days shall have elapsed from the date on which such explanation is furnished to the participant or beneficiary or, if earlier, the date any payment is made in accordance with such election. The Board shall prescribe such regulations as may be necessary to carry out the provisions of this subsection.

FILING WITH THE BOARD

SEC. 1112. (a)(1) The administrator of any public employee pension benefit plan subject to this Act shall file with the Board the annual report for a plan year within two hundred and ten days after the close of such year (or within such time as may be required by regulations promulgated by the Board). The administrator shall also furnish to the Board, upon request, any documents relating to the plan, including but not limited to the bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated.

(2) Except as provided in subsection (b) and paragraph (3) of this subsection, the contents of the descriptions, annual reports, statements, and other documents filed with the Board pursuant to this title shall be public information and the Board shall make any such information and data available for inspection in the public document room of the Board. The Board and the Advisory Council on Governmental Plans (established under section 1308) may use the information and data for statistical and research purposes, and compile and publish such studies, analyses, reports, and surveys based thereon as they may consider appropriate.

(3)(A) Any information consisting of the contents of the descriptions, annual reports, statements, and other documents filed with the Board pursuant to this title may be provided in computer-compatible form to the public only after a statement has been filed with the Board by the person receiving the information which provides that the information will not be—

(i) used by that person in the distribution of solicitations, by mail, telephone, or otherwise, for any commercial purpose, or

(ii) given by the person receiving the information to any other person who the person receiving the information has reasonable grounds to believe will use such information in the distribution of solicitations, by mail, telephone, or otherwise, for any commercial purpose.

(B) Any person who files a statement described in subparagraph (A) and who takes any action described in clause (i) or (ii) of subparagraph (A) shall be subject to a civil penalty of an amount not to exceed $5,000. Any such penalty shall be assessed by the Board.

(b) Information required to be furnished pursuant to subsections (a) and (c) of section 1111 with respect to a participant may be disclosed by the Board only to the extent that information with respect to that participant's benefits under title II of the Social Security Act (42 U.S.C. 401 et seq.) may be disclosed under such Act.

(c) The Board may reject any filing under this section if the Board determines that—

(1) such filing is incomplete, or

(2) there is any material qualification by an accountant or actuary contained in an opinion or statement submitted pursuant to section 1106 or 1107.

(d)(1) Paragraph (2) shall apply in any case in which—

(A) the Board rejects a filing of a report under subsection (c),

(B) a revised filing satisfactory to the Board is not submitted within forty-five days after the Board makes a determination under subsection (c) to reject the filing, and

(C) the Board considers it in the best interest of the participants.

(2) In any case to which this paragraph applies, the Board may take, in addition to any other action authorized by this Act, any one or more of the following actions:

(A) retain an independent qualified public accountant (as defined in section 1106(a)(4)) on behalf of the participants to perform an audit,

(B) retain an enrolled actuary, on behalf of the plan participants, to prepare an actuarial report, or

(C) bring a civil action for such legal or equitable relief as may be appropriate to enforce the provisions of this title.

The administrator shall permit such accountant or actuary to make such inspection of the books and records of the plan as the accountant or actuary considers necessary to conduct any such audit or prepare any such actuarial report. The plan shall be liable to the Board for the expenses for any such audit or actuarial report, and the Board may bring an action against the plan in any court of competent jurisdiction to recover such expenses.

RETENTION OF RECORDS

SEC. 1113. Every person who is subject to a requirement to file any description or report or to certify any information therein under this Act, or who would be subject to such a requirement but for an exemption under section 1115 or simplified reporting requirement under section 1104(b)(2), shall maintain records on the matters of which disclosure is thus required or would have been required but for such an exemption or simplified reporting requirement. Such records shall provide in sufficient detail the necessary basic information and data from which the documents which are required or which would have been required may be reconstructed, verified, explained, or clarified, and checked for accuracy and completeness, including but not limited to vouchers, worksheets, receipts, computer tapes and discs, and applicable resolutions. Such records shall be kept available for examination for a period of not less than six years after the filing date of the documents based on the information which they contain, or not less than six years after the date on which such documents would have been filed but for an exemption under section 1115 or simplified reporting requirement under section 1104(b)(2).

CLAIMS PROCEDURE

SEC. 1114. In accordance with such regulations as the Board may prescribe, every plan shall provide to any participant or beneficiary whose claim for benefits under the plan has been denied in whole or in part—

(1) adequate notice setting forth the specific reasons for such denial and written in a manner calculated to be understood by the participant or beneficiary, and

(2) a reasonable opportunity for a full and fair review of the decision denying the claim.

ALTERNATIVE METHODS OF COMPLIANCE; OTHER EXEMPTIONS

SEC. 1115. (a) The Board may take the following actions with respect to any public employee pension benefit plan to which this Act applies:

(1) The Board, on the Board's own motion or after having received the petition of an administrator, may prescribe an alternative method for satisfying any requirement of this title with respect to any plan, or class of plans, subject to such requirement if the Board determines that—

(A) the use of such alternative method is consistent with the purposes of this Act and it provides adequate disclosure to the participants and beneficiaries in the plan and to other persons entitled to disclosure under this title, and adequate reporting to the Board, and

(B) the application of such alternative method would—

(i) substantially decrease the costs to the plan, or

(ii) avoid unreasonable administrative burdens with respect to the operation of the plan.

(2) The Board may prescribe an alternative method under subsection (a) by regulation or otherwise. If an alternative method is prescribed other than by regulation, the Board shall provide notice and an opportunity for interested persons to present their views, and shall publish in the Federal Register the provisions of such alternative method.

(3) The Board may by regulation exempt any plan or any class of plans conditionally or unconditionally from any requirement of this title if the Board determines, after giving full consideration to the use of alternative methods, that such exemption is—

(A) appropriate and necessary in the public interest, and

(B) consistent with the purposes of this Act.

(b) Before issuing any exemption or prescribing any alternative method under this section, the Board shall take into account any recommendations made by the Advisory Council on Governmental Plans (established under section 1308).

Subtitle B—Fiduciary Responsibility

SPECIAL ASSET RULES

SEC. 1201. For purposes of this title:

(1) In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.), the assets of such plan shall be deemed to include such security but shall not, solely by reason of such investment, be deemed to include any assets of such investment company.

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

ESTABLISHMENT OF PLAN

SEC. 1202. (a)(1) Every plan shall be established and maintained pursuant to written instruments. Such instruments shall provide for the designation of one or more named fiduciaries, in a plan instrument or pursuant to a procedure specified in a plan instrument, who shall have authority to control and manage the operation and administration of the plan.

(2) For purposes of this title, the term "instrument" shall include a law of a State or of a political subdivision of a State.

(b) Every plan shall—

(1) state whether a funding policy or goal has been established for the plan, and shall describe the funding policy or goal, the method for carrying out such policy or goal, if any, and the source of funds,

(2) describe the procedure under the plan for any allocation of duties relating to the operation and administration of the plan (including any allocation or designation under subsection (c)(4)),

(3) provide a procedure for amending such plan, and for identifying the persons who have authority to amend the plan, except to the extent that the procedure for amending such plan is by legislation,

(4) specify the provisions relating to benefits (including but not limited to eligibility, benefit levels, and the form and method of payment of benefits), and

(5) provide a procedure for determining whether contributions from all employers or employer representatives are made in a timely manner and for resolving any disputes as to the timing or amount of such contributions.

(c) Any plan may provide that—

(1) any person or group of persons may serve in more than one fiduciary capacity with respect to the plan (including service both as trustee and as named fiduciary);

(2) a named fiduciary may employ one or more persons to render advice with respect to any duty such named fiduciary has under the plan;

(3) a person who is a named fiduciary with investment duties with respect to the plan may appoint one or more investment managers as fiduciaries to manage (including the power to acquire and dispose of) any assets of a plan;

(4) named fiduciaries may allocate duties (other than trustee duties) among themselves and designate others as fiduciaries to carry out specific fiduciary activities (other than trustee duties); and

(5) trustee duties may be allocated among trustees named or appointed under section 1203; and

(6) the trustee or trustees of the plan named or appointed under section 1203 are subject to the direction of a named fiduciary.

(d) For purposes of this title, the term "trustee duty" means any duty provided in the plan's trust instrument (if any) relating to the management or control of the assets of the plan, other than the appointment, as provided in the trust instrument, by a named fiduciary of an investment manager in accordance with subsection (c)(3).

ESTABLISHMENT OF TRUST

SEC. 1203. (a) Except as provided in subsection (b), all assets of a plan shall be held in trust by one or more trustees. Any such trustee shall be a named fiduciary or appointed by a named fiduciary. Upon acceptance of being named or appointed, the trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that—

(1) the plan expressly provides pursuant to section 1202(c)(6) that the trustee or trustees are subject to the direction of a named fiduciary, in which case the trustee or trustees shall be subject to proper directions of such named fiduciary which are made in accordance

with the terms of the plan and which are consistent with the requirements of this title, or

(2) authority to manage, acquire, or dispose of assets of the plan is delegated by a named fiduciary to one or more investment managers pursuant to section 1202(c)(3).

(b) The requirements of subsection (a) of this section shall not apply—

(1) to any assets of a plan which consist of insurance contracts or policies issued by an insurance company qualified to do business in a State; or

(2) to any assets of such an insurance company or any assets of a plan which are held by such an insurance company.

(c)(1) Except as provided in paragraph (2), the assets of a plan shall never inure to the benefit of any employer, employer representative, or other person employing participants in the plan and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

(2) In the case of a contribution which is made by a mistake of fact or law, paragraph (1) shall not prohibit the return of such contribution within one year after the adminis-

trator determines that the contribution was made by such a mistake.

GENERAL REQUIREMENTS RELATING TO FIDUCIARY DUTIES

SEC. 1204. (a) Subject to section 1203(c), a fiduciary shall discharge such fiduciary's duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(1) for the exclusive purpose of—

(A) providing benefits to participants and their beneficiaries; and

(B) defraying reasonable expenses of administering the plan;

(2) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person 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;

(3) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(4) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this Act.

(b) Except as authorized by the Board by regulation, no fiduciary may maintain the indicia of ownership of any assets of a plan outside the jurisdiction of the district courts of the United States.

(c) In the case of a plan which provides for individual accounts and permits a participant or beneficiary to exercise control over assets in the account of the participant or beneficiary, if the participant or beneficiary exercises control over the assets in the account (as may be determined under regulations of the Board)—

(1) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and

(2) no person who is otherwise a fiduciary shall be liable under this title for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control.

EXTENT OF COFIDUCIARY DUTIES

SEC. 1205. (a)(1)(A) Except to the extent otherwise required in subsection (b) with regard to named fiduciaries who are trustees, if a public employee pension benefit plan provides for the allocation of fiduciary duties among named fiduciaries, a named fiduciary to whom a specific duty has not been allocated shall not be responsible or liable for an act or omission, in connection with that duty, by the named fiduciary to whom that duty has been allocated.

(B) Subparagraph (A) shall not apply with respect to an allocation referred to in such subparagraph to the extent that the allocation, or the continuation thereof, is a violation of section 1204(a). Nothing in subparagraph (A) shall be construed to relieve a named fiduciary from responsibility or liability for any act by the named fiduciary.

(2)(A) Except to the extent otherwise required in subsection (b) with regard to named fiduciaries who are trustees, if a public employee pension benefit plan provides for the designation by named fiduciaries of other persons as fiduciaries to carry out specific fiduciary activities, a named fiduciary shall not be responsible or liable for an act or omission, in connection with that specific fiduciary activity, by the person who has been so designated by that or any other named fiduciary to carry out that fiduciary activity.

(B) Subparagraph (A) shall not apply with respect to a designation referred to in such subparagraph to the extent that the designation, or the continuation thereof at any time under the circumstances then prevailing, is a violation of section 1204(a). Nothing in subparagraph (A) shall be construed to relieve a named fiduciary from responsibility or liability for any act by the named fiduciary.

(b) If the assets of a public employee pension benefit plan are held by two or more trustees—

(1) each such trustee shall use reasonable care to prevent any other such trustee from committing a breach; and

(2) all such trustees shall jointly manage and control the assets of the plan;

except that nothing in this subsection shall be construed to attribute a duty to a trustee which would be inconsistent with a direction by a named fiduciary under paragraph (1) of subsection (a) of section 1203 or with a delegation by a named fiduciary under paragraph (2) of such subsection.

PROHIBITED TRANSACTIONS

SEC. 1206. A fiduciary with respect to a plan shall not—

(1) deal with the assets of the plan in the fiduciary's own interest or for the fiduciary's own account,

(2) in the fiduciary's individual or in any other capacity, act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for such fiduciary's own personal account from any party dealing with such

plan in connection with a transaction involving the assets of the plan.

TEN PER CENTUM LIMITATION WITH RESPECT TO ACQUISITION OF EMPLOYER SECURITIES, OTHER EMPLOYER OBLIGATIONS, AND EMPLOYER REAL PROPERTY

SEC. 1207. (a)(1) Except as otherwise provided in this section—

(A) a plan may not acquire—

(i) any employer security which is not a qualifying employer security,

(ii) any employer real property which is not qualifying employer real property, or

(iii) any employer loan (including any other extension of credit) which is not a qualifying employer loan, and

(B) a plan may not acquire any qualifying employer security, qualifying employer real property, or qualifying employer loan, if immediately after such acquisition the aggregate fair market value of employer securities, employer real property, and employer loans held by the plan exceeds 10 per centum of the fair market value of the assets of the plan.

(2) Notwithstanding paragraph (1)(B), a plan may acquire qualifying employer securities, qualifying employer real

property, and qualifying employer loans if such acquisitions are made pursuant to a binding contractual obligation made prior to the date of the enactment of this Act.

(b) For purposes of this section—

(1) The term "employer security" means a security issued by an employer of employees covered by the plan, an employer representative of such an employer, or any other person required to make employer contributions under the plan, or by an affiliate of such employer or employer representative.

(2) The term "qualifying employer security" means an employer security which is stock or a marketable obligation (as defined in subsection (c)).

(3) The term "employer real property" means real property (and related personal property) which is leased to an employer of employees covered by the plan, an employer representative of such an employer, or any other person required to make employer contributions under the plan, or to an affiliate of such employer or employer representative. For purposes of determining the time at which a plan acquires employer real property for purposes of this section, such property shall be deemed to be acquired by the plan on the date on which the plan acquires the property or on the date on which the lease to such an employer (or affiliate

thereof), such an employer representative (or affiliate thereof), or such other person is entered into, whichever is later.

(4) The term "qualifying employer real property" means one or more parcels of employer real property—

(A) if, in the case of employer real property consisting of three or more parcels, a substantial number of the parcels are dispersed geographically;

(B) if each parcel of real property and the improvements thereon are suitable (or adaptable without excessive cost) for more than one use; and

(C) if the acquisition of such property complies with the provisions of this title (other than section 1204(a)(2) to the extent it requires diversification, section 1204(a)(3), section 1206, and subsection (a) of this section).

(5) The term "employer loan" means a loan or other extension of credit, not otherwise described in paragraph (1), issued or otherwise entered into by an employer of employees covered by the plan, an employer representative of such an employer, or any other person required to make employer contributions under the plan, or by an affiliate of such employer or

employer representative. A failure by such an employer, employer representative, or other person to make contributions when due, unless evidenced by a promissory note, shall not be considered a loan or other extension of credit.

(6) The term "qualifying employer loan" means an employer loan which bears a rate of interest which is consistent with the fiduciary duties under section 1204 and which is fully secured by marketable securities, or such other employer loan as defined under regulations issued by the Board.

(7)(A) The term "affiliate" means—

(i) when used in connection with any person referred to in subparagraph (B), any other person referred to in subparagraph (B); and

(ii) when used in connection with an employer representative (as defined in section 1002(17)(B)) acting in the interest of any person referred to in subparagraph (B), such person or any other person referred to in subparagraph (B).

(B) The persons referred to in this subparagraph are the following: a State; any agency or instrumentality of such State; any political subdivision of such State; any agency or instrumentality of any political subdivision of such State; and any group or association consisting, in whole or in part, of any combination of the foregoing.

(c) For purposes of subsection (b)(2), the terms "marketable obligation" and "obligation" mean a bond, debenture, note, certificate, or other evidence of indebtedness if—

(1) the obligation is acquired—

(A) on the market, either (i) at the price of the obligation prevailing on a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f), or (ii) if the obligation is not traded on such a national securities exchange, at a price not less favorable to the plan than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer;

(B) from an underwriter, at a price (i) not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular, and (ii) at which a substantial portion of the same issue is acquired by persons independent of the issuer; or

(C) directly from the issuer, at a price not less favorable to the plan than the price paid currently for a substantial portion of the same issue by persons independent of the issuer; and

(2) immediately following acquisition of such obligation—

(A) not more than 25 per centum of the aggregate amount of obligations issued in such issue and outstanding at the time of acquisition is held by the plan, and

(B) at least 50 per centum of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer.

EXEMPTIONS FROM PROHIBITED TRANSACTIONS

SEC. 1208. (a) The Board shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, the Board may grant a conditional or unconditional exemption of any fiduciary or transaction, or class of fiduciaries or transactions, from all or part of the restrictions imposed by section 1206. An exemption granted under this subsection shall not relieve a fiduciary from any other applicable provisions of this Act. The Board may not grant an exemption under this subsection unless the Board finds that such exemption is—

(1) administratively feasible,

(2) in the interests of the plan and of its participants and beneficiaries, and

(3) protective of the rights of participants and beneficiaries of such plan.

The Board may not grant an exemption under this subsection from section 1206 unless the Board affords an opportunity for a hearing and makes a determination on the record with respect to the findings required by paragraphs (1), (2), and (3).

(b) The prohibitions provided in section 1206 shall not apply to any of the following transactions:

(1) Any loans made by the plan to parties in interest who are participants or beneficiaries of the plan if such loans—

(A) are available to all such participants and beneficiaries on a reasonably equivalent basis,

(B) are not made available to highly compensated employees, officers, or fiduciaries in an amount greater than the amount made available to other employees,

(C) are made in accordance with specific provisions regarding such loans set forth in the plan,

(D) bear a rate of interest which is consistent with the fiduciary duties under section 1204, and

(E) are adequately secured.

(2) Contracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the estab-

lishment or operation of the plan, if no more than reasonable compensation is paid therefor.

(3) The investment of all or part of a plan's assets, in deposits which bear an interest rate which is consistent with the fiduciary duties under section 1204, in a bank or similar institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if the investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or other institution or an affiliate thereof) who is expressly empowered by the plan to authorize such investment.

(4) The providing of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan, and if—

(A) such bank or other institution has adopted adequate internal safeguards which assure that the providing of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and

(B) the extent to which such ancillary service is provided is subject to specific guidelines issued by such institution (as determined by the Board after consultation with Federal and State supervisory authority), and adherence to such guidelines would reasonably preclude such bank or other institution from providing such ancillary service (i) in an excessive or unreasonable manner, and (ii) in a manner that would be inconsistent with the best interests of participants and beneficiaries of plans.

Such ancillary services shall not be provided at more than reasonable compensation.

(5) Any transaction between a plan and (A) a common or collective trust fund or pooled investment fund maintained by a party in interest which is a bank or trust company supervised by a State or Federal agency or (B) a pooled investment fund of an insurance company qualified to do business in a State, if—

(i) the transaction is a sale or purchase of an interest in the fund,

(ii) the bank, trust company, or insurance company receives not more than reasonable compensation, and

(iii) such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who has authority to manage and control the assets of the plan.

(c) Nothing in section 1206(b) shall be construed to prohibit—

(1) a fiduciary or party in interest from receiving any benefit to which the fiduciary or party in interest may be entitled as a participant or beneficiary in the plan, or paying any benefit to any participant or beneficiary, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as generally applied to all participants and beneficiaries;

(2) a fiduciary or party in interest from receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of the functions of the fiduciary or party in interest with respect to the plan, except that no person so serving who already receives full-time pay from an employer whose employees are participants in the plan, an employer representative of such an employer, or an employee organization whose members are participants in such plan, shall receive compensation from such plan, except for reimbursement of expenses properly and actually incurred; or

(3) a fiduciary from serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest.

(d)(1) For purposes of sections 1206 and 1207, the assets of a plan shall not include assets in a pooled separate account of an insuror (as defined in section 1201(2)) or assets in a collective investment fund of a bank or similar financial institution supervised by the United States or a State.

(2)(A) For purposes of this subsection, the terms "pooled separate account" and "collective investment fund" mean, when used in connection with a plan, a separate account or fund in which plans (as defined in section 1002(26) of this Act or section 3(3) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(3))), including such plan, of five or more plan sponsors (as defined in section 1002(24) of this Act or section 3(16)(B) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(16)(B))) who are not affiliates participate, and in which no plan (as so defined), either alone or together with plans (as so defined) of the same plan sponsor (as so defined) and its affiliates, has a 50 per centum or more interest.

(B) For purposes of this paragraph, the term "affiliate" means—

(i) in connection with a plan sponsor (as defined in section 3(16)(B) of the Employee Retirement Income

Security Act of 1974 (29 U.S.C. 1002(16)(B))), any person if—

(I) such person owns, directly or indirectly, 50 per centum or more of the outstanding ownership interest in such plan sponsor,

(II) such plan sponsor owns, directly or indirectly, 50 per centum or more of the outstanding ownership interest in such person,

(III) 50 per centum or more of the outstanding ownership interest of both such person and such plan sponsor are owned directly or indirectly by the same person or persons, or

(IV) in any case in which such person is an association, committee, joint board of trustees, or other similar group described in section 3(16)(B)(iii) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(16)(B)(iii)) and such plan sponsor is an association, committee, joint board of trustees, or other similar group described in such section, 50 per centum or more of the members of one of them are also members of the other; and

(ii) in connection with a plan sponsor (as defined in section 1002(24) of this Act), the government of any State in which such plan sponsor is located, a political subdivision of such State, and any agency or instrumentality of such State or political subdivision.

(e) Section 1206 shall not apply to the acquisition or sale by a plan of qualifying employer securities (as defined in section 1207(b)(2)), the acquisition, sale, or lease by a plan of qualifying employer real property (as defined in section 1207(b)(4)), or the acquisition of a qualifying employer loan (as defined in section 1207(b)(6))—

(1) if such acquisition, sale, or lease is for adequate consideration (or in the case of a marketable obligation, at a price not less favorable to the plan than the price determined under section 1207(c)(1)),

(2) if no commission is charged with respect thereto, and

(3) if the acquisition or lease is not prohibited by section 1207(a).

LIABILITY FOR BREACH OF FIDUCIARY DUTIES

SEC. 1209. (a) Any person who is a fiduciary with respect to a plan who breaches any of the duties imposed upon fiduciaries by this Act shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary or any other person, and shall be subject to such equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 1211.

(b) No person shall be liable with respect to a breach of fiduciary duties under this Act if such breach occurred before such person became a fiduciary or after such person ceased to be a fiduciary.

EXCULPATORY PROVISIONS; INSURANCE

SEC. 1210. (a) Except as otherwise provided in this title, any provision in an agreement or instrument which purports to relieve a fiduciary from a responsibility or liability for any duty under this Act shall be void as against public policy.

(b) Nothing in this section shall preclude—

(1) a plan from purchasing insurance for its fiduciaries or for itself to cover liability or losses occurring by reason of the act or omission of a fiduciary;

(2) a fiduciary from purchasing insurance to cover liability under this title from and for such fiduciary's own account; or

(3) an employer, employer representative, or employee organization from purchasing insurance to cover potential liability of one or more persons who serve as fiduciaries with respect to a plan.

PROHIBITION AGAINST CERTAIN PERSONS HOLDING CERTAIN POSITIONS

SEC. 1211. (a)(1) No person who has been convicted of, or has been imprisoned as a result of such person's conviction for, robbery, bribery, extortion, embezzlement, fraud, grand larceny, burglary, arson, a felony violation of Federal or State law involving substances defined in section 102(6) of the Comprehensive Drug Abuse Prevention and Control Act of 1970 (21 U.S.C. 802(6)), murder, rape, kidnaping, perjury, assault with intent to kill, any crime described in section 9(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a–9(a)(1)), a violation of any provision of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1001 et seq.), a violation of section 302 of the Labor-Management Relations Act of 1947 (29 U.S.C. 186), a violation of chapter 63 of title 18, United States Code, a violation of section 874, 1027, 1503, 1505, 1506, 1510, 1951, or 1954 of title 18, United States Code, a violation of the Labor-Management Reporting and Disclosure Act of 1959 (29 U.S.C. 401 et seq.), or conspiracy to commit any such crimes or attempt to commit any such crimes, or a crime of which any of the foregoing crimes is an element, shall serve or be permitted to serve as an administrator, officer, trustee, custodian, counsel, agent, or consultant or in any other capacity as a fiduciary, with respect to any public employee pension benefit plan during or for five years after such conviction or after the end of such imprisonment, whichever is the later, unless prior to the end of such five-year period, in the case of a person so convicted or imprisoned, (A) such person's citizenship rights, having been revoked as a result of such conviction, have been fully restored, or (B) the Board of Parole of the United States Department of Justice determines that such person's service as a fiduciary would not be contrary to the purposes of this Act.

(2) Before making any such determination the Board shall hold an administrative hearing and shall give notice of such proceeding by certified mail to the State, county, and Federal prosecuting officials in the jurisdiction or jurisdictions in which such person was convicted. The Board's determination in any such proceeding shall be final. No person shall knowingly permit any other person to serve as an administrator, officer, trustee, custodian, counsel, or consultant or in any other capacity as a fiduciary in violation of this subsection.

(3) Notwithstanding the preceding provisions of this subsection, no corporation or partnership will be precluded from serving as a fiduciary with respect to any plan without a notice, hearing, and determination by such Board of Parole that such service would be inconsistent with the intention of this section.

(b) For the purposes of this section:

(1) A person shall be deemed to have been "convicted" and under the disability of "conviction" from the date of the judgment of the trial court or the date of the final sustaining of such judgment on appeal, whichever is later.

(2) The term "consultant" means any person who, for compensation, advises or represents a plan or who provides other assistance to such plan, concerning the establishment or operation of such plan.

(3) A period of parole shall not be considered as part of a period of imprisonment.

(c) Notwithstanding any other provision of this section, no elected official shall be precluded from serving as a fiduciary because of a conviction described in subsection (a) if the fiduciary serves solely by reason of the requirements of the fiduciary's elected office.

BONDING

SEC. 1212. (a) Every fiduciary with respect to a plan and every person who handles funds or other property of such a plan (hereinafter in this section referred to as "plan official") shall be bonded as provided in this section; except that—

(1) if such plan is one under which the only assets from which benefits are paid are the general assets of

an employee organization, or of an employer or of an employer representative, the administrator, officers, and employees of such plan shall be exempt from the bonding requirements of this section, and

(2) no bond shall be required of a fiduciary (or of any director, officer, or employee ~~of~~ such fiduciary) if such fiduciary—

(A) is a corporation organized and doing business under the laws of the United States or of any State;

(B) is authorized under such laws to exercise trust powers or to conduct an insurance business;

(C) is subject to supervision or examination by Federal or State authority; and

(D) has at all times a combined capital and surplus in excess of such a minimum amount as may be established by regulations issued by the Board, which amount shall be at least $1,000,000.

Paragraph (2) shall apply to a bank or other financial institution which is authorized to exercise trust powers and the deposits of which are not insured by the Federal Deposit Insurance Corporation only if such bank or institution meets bonding or similar requirements under State law which the Board determines are at least equivalent to those imposed on banks by Federal law.

(b)(1) The amount of such bond shall be fixed at the beginning of each fiscal year of the plan. Such amount shall be not less than 10 per centum of the amount of funds handled. In no case shall such bond be less than $1,000 nor more than $500,000, except that the Board, after due notice and opportunity for hearing to all interested parties, and after consideration of the record, may prescribe an amount in excess of $500,000, which in no event may exceed 10 per centum of the funds handled.

(2) For purposes of fixing the amount of such bond, the amount of funds handled shall be determined by the funds handled by the person, group, or class to be covered by such bond and by their predecessor or predecessors, if any, during the preceding reporting year, or if the plan has no preceding reporting year, the amount of funds to be handled during the current reporting year by such person, group, or class, estimated as provided in regulations of the Board.

(3) Such bond shall provide protection to the plan against loss by reason of acts of fraud or dishonesty on the part of the plan official, directly or through connivance with others. Any bond shall have as surety thereon a corporate surety company which is an acceptable surety on Federal bonds under authority granted by the Secretary of the Treas-

ury pursuant to sections 6 through 13 of title 6, United States Code. Any bond shall be in a form or of a type approved by the Board, including individual bonds or schedule or blanket forms of bonds which cover a group or class.

(c) It shall be unlawful for any plan official to whom subsection (a) applies to receive, handle, disburse, or otherwise exercise custody or control of any of the funds or other property of any plan, without being bonded as required by subsection (a) and it shall be unlawful for any plan official of such plan, or any other person having authority to direct the performance of such functions, to permit such functions, or any of them, to be performed by any plan official, with respect to whom the requirements of subsection (a) have not been met.

(d) It shall be unlawful for any person to procure any bond required by subsection (a) from any surety or other company or through any agent or broker in whose business operations such plan or any party in interest in such plan has any control or significant financial interest, direct or indirect.

(e) The Board shall prescribe such regulations as may be necessary to carry out the provisions of this section, including exempting a plan from the requirements of this section in any case in which the Board finds that—

(1) other bonding arrangements would be adequate to protect the interests of the beneficiaries and participants, or

(2) each employer and employer representative, and any affiliate of each such employer or employer representative (within the meaning of section 1207(b)(7))—

(A) is obligated to provide protection to the plan against loss by reason of acts of fraud or dishonesty on the part of persons subject to subsection (a), and

(B) demonstrates reasonable assurance to the Board of fulfilling such obligation.

In any case in which, in the opinion of the Board, the administrator of a plan offers adequate evidence of the financial responsibility of the plan, or that other bonding arrangements would provide adequate protection for the beneficiaries and participants, the Board may modify or exempt such plan from some or all of the requirements of this section.

LIMITATION ON ACTIONS

SEC. 1213. No action may be commenced under this Act with respect to a fiduciary's breach of any duty under this title or with respect to any other violation of this title, after the earlier of—

(1) six years after (A) the date of the last action which constituted a part of the failure or violation, or (B) in the case of an omission, the latest date on which the fiduciary could have cured the failure or violation, or

(2) three years after the earlier of—

(A) the date on which the plaintiff had actual knowledge of the failure or violation, or

(B) the date on which a report from which the plaintiff could reasonably be expected to have obtained knowledge of such failure or violation was filed with the Board under this Act;

except that in the case of fraud or concealment, such action may be commenced not later than six years after the date of discovery of such failure or violation.

CERTAIN ACTIONS OF GOVERNMENT OFFICIALS NOT CONSIDERED FIDUCIARY DUTIES

SEC. 1214. Notwithstanding any other provision of this Act—

(1) no legislator shall individually be considered a fiduciary with respect to actions taken in a legislative capacity, and

(2) no person acting in a governmental capacity shall be considered a fiduciary with respect to actions taken regarding the establishment of plan provisions

relating to benefits (including but not limited to eligibility, benefit levels, and the form and method of payment of benefits), the establishment of funding levels for benefits or administrative costs, or the appropriation of funds to meet such funding levels for benefits or administrative costs.

Subtitle C—Administration and Enforcement

CIVIL ENFORCEMENT

SEC. 1301. (a)(1) For purposes of any civil action brought under this section, the requirements of any law of a State or a political subdivision of a State described in section 1102 shall be deemed to be requirements of this title.

(2) A civil action may be brought by—

(A) any person described in section 1110(b) in order to enforce a request for information provided for under this title or to obtain the relief provided for under subsection (b)(1) of this section;

(B) the Board, the attorney general (or equivalent official) of a State in which the plan is established, or a participant, beneficiary, or fiduciary in order to—

(i) obtain appropriate relief under section 1209,

(ii) enjoin any act or practice which violates any provision of this title, or

(iii) obtain other appropriate equitable relief to redress any such violation or to enforce any such provision; and

(C) the Board or the attorney general (or equivalent official) of a State in which the plan is established to collect any civil penalty under subsection (b)(2) or (j) of this section or under section 1112(a)(3)(B).

(b)(1) Any administrator who fails or refuses to comply with a request for any information which such administrator is required by this title to furnish to a person described in section 1110(b) or section 1111(a) by mailing the material requested to the last known address of such person within sixty days after such request, may in the court's discretion be personally liable to such person in the amount of up to $100 a day from the date of such failure or refusal, unless such failure or refusal results from matters reasonably beyond the control of the administrator. The court may in its discretion order such other relief as it considers proper.

(2) In the case of a failure to file any form required under subtitle A of this title on the date and in the manner prescribed (determined without regard to any extension of time for filing), upon notice and demand by the Board there shall be paid by the person failing to file, $10 for each day during which such failure continues, but the total amount imposed under this subsection on any person for failure to file

any return shall not exceed $5,000. Such penalty shall be assessed by the Board unless it is shown that such failure is due to reasonable cause. For purposes of this subsection, the Board may assess such penalty for failure to file on any person who makes a timely filing which is incomplete in any material respect.

(c)(1) A plan may sue or be sued under this title as a person. Service of summons, subpoena, or other legal process of a court upon a trustee or an administrator of a plan in the trustee's or administrator's capacity as such shall constitute service upon the plan. If a plan has not designated in its summary plan description an individual as agent for the service of legal process, service upon the Board shall constitute such service. The Board, not later than fifteen days after receipt of service under the preceding sentence, shall notify the administrator, any named fiduciary, or any trustee of the plan of receipt of such service.

(2) Any money judgment under this title against a plan shall be enforceable only against the plan as a person and shall not be enforceable against any other person unless liability against such person is established in such person's individual capacity under this title.

(d)(1) Except as otherwise provided in this paragraph, the district courts of the United States shall have exclusive jurisdiction of civil actions brought under this title. State courts of competent jurisdiction and district courts of the United States shall have concurrent jurisdiction of actions brought under subparagraphs (A) and (C) of subsection (a)(2) and actions brought under any law referred to in section 1102.

(2) Notwithstanding section 94 of the National Banking Act (12 U.S.C. 94), in any case in which an action under this title is brought in a district court of the United States, it may be brought in any district of the State where the plan is administered, where the breach took place, or where a defendant resides or may be found, and process may be served in any other district where a defendant resides or may be found.

(e) The district courts of the United States shall have jurisdiction without regard to the amount in controversy or the citizenship of the parties, to grant the relief provided for in subsection (a) of this section in any action.

(f) In any action brought under this title by a participant, beneficiary, or fiduciary, the court—

(1) shall award a reasonable attorney's fee and costs of action to the plaintiff if the plaintiff prevails or substantially prevails in the action, unless the court in its discretion determines that the defendant acted in good faith and that such award will not further the purposes of this title; and

(2) may in its discretion award a reasonable attorney's fee and costs of action to any defendant who prevails or substantially prevails in such action.

(g) A copy of the complaint in any action brought under this title shall be served upon the Board by certified mail. The Board shall have the right in its discretion to intervene in any such action.

(h) Suits by an administrator, fiduciary, participant, or beneficiary of a plan to review a final order of the Board, to restrain the Board from taking any action contrary to the provisions of this title, or to compel the Board to take action required under this title, may be brought in any district court of the United States in the State where the plan has its principal office, or in the United States District Court for the District of Columbia.

(i) In all civil actions under this title, attorneys appointed by the Board may represent the Board (except as provided in section 518(a) of title 28, United States Code).

(j)(1) In the case of a transaction by a party in interest which is prohibited by section 1206, the Board or the attorney general (or equivalent official) of a State in which the plan is established may assess and collect a civil penalty against such party in interest involved in such transaction. The amount of such penalty may not exceed 5 per centum of the amount involved, except that if the transaction is not corrected (in such manner and within such correction period as the Board shall prescribe by regulation), such penalty may be in an amount not more than 100 per centum of the amount involved.

(2) For purposes of this subsection—

(A) the term "amount involved" means, with respect to a prohibited transaction, the greater of the amount of money and the fair market value of other property given or the amount of money and the fair market value of other property received; except that, in the case of services, the amount involved shall be only the excess compensation;

(B) in the case of the initial 5 per centum penalty, the fair market value shall be determined as of the date on which the prohibited transaction occurs;

(C) in the case of the 100 per centum penalty, the fair market value shall be the highest fair market value during the correction period; and

(D) the term "correct" means, with respect to a prohibited transaction, undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than that in which it would be if the party in interest were acting in accordance with the fiduciary standards described in title II.

(k) The attorney general (or equivalent official) of a State may bring an action under subsection (a)(2)(B) or (a)(2)(C) (other than an action under any law referred to in section 1102) only if such official first notifies the Board of the official's intention to bring such action, and the Board does not, within forty-five days, indicate its intention to bring an action under such subsections.

INVESTIGATIVE AUTHORITY

SEC. 1302. (a) The Board shall have the power, in order to determine whether any person has violated or is about to violate any provision of this title or any regulation or order thereunder—

(1) to make an investigation, and in connection therewith to require the submission of reports, books, and records, and the filing of data in support of any information required to be filed with the Board under this title, and

(2) to enter such places, inspect such books and records, and question such persons as the Board may deem necessary to enable the Board to determine the facts relative to such investigation, if the Board has reasonable cause to believe there may exist a violation of this title, or any rule or regulation issued thereunder or if the entry is pursuant to an agreement with the plan.

The Board may make available to any person actually affected by any matter which is the subject of an investigation under this section, and to any department or agency 4f the United States, information concerning any matter which may be the subject of such investigation.

(b) The Board may not under the authority of this section require any plan to submit to the Board any books or records of the plan more than once in any twelve-month period, unless the Board has reasonable cause to believe there may exist a violation of this title or any regulation or order thereunder.

(c) For the purposes of any investigation provided for in this title, the provisions of sections 9 and 10 (relating to the attendance of witnesses and the production of books, records, and documents) of the Federal Trade Commission Act (15 U.S.C. 49, 50) are hereby made applicable (without regard to any limitation in such sections with respect to persons, partnerships, banks, or common carriers) to the jurisdiction, powers, and duties of the Board or any officers designated by the Board. To the extent the Board considers appropriate, the Board may delegate the Board's investigative functions under this section with respect to insured banks acting as fiduciaries of plans to the appropriate Federal banking agency (as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))).

REGULATIONS

SEC. 1303. (a) The Board may prescribe such regulations as the Board finds necessary or appropriate to carry out the provisions of this title. Among other things, such regulations may—

(1) define accounting, technical, and trade terms used in such provisions; and

(2) provide for the keeping of books and records, and for the inspection of such books and records (subject to section 1302 (a) and (b)).

(b) Before issuing any proposed regulations with respect to any matter under this title, the Board shall—

(1) consult with employers, employee organizations, administrators, and other interested persons, and

(2) actively consider the advice and recommendations of the Advisory Council on Governmental Plans (established under section 1308) with respect to such matter.

COOPERATION WITH STATES

SEC. 1304. In order to avoid unnecessary cost to Federal, State, and local government agencies, the Board shall cooperate with State and local governments in the exchange of information and data on plans and shall make such arrangements as may be necessary to provide to and receive from

State and local governments information and data at the lowest possible cost.

ADMINISTRATION

SEC. 1305. (a) Subchapter II of chapter 5, and chapter 7, of title 5, United States Code (relating to administrative procedure), shall be applicable to this title.

(b) No employee of the Board shall administer or enforce this title with respect to (1) any plan under which the employee is a participant or beneficiary or (2) any employee organization of which the employee is a member.

INTERFERENCE WITH RIGHTS PROTECTED UNDER TITLE

SEC. 1306. It shall be unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which such participant or beneficiary is entitled under this title, or for the purpose of interfering with the attainment of any right to which such participant or beneficiary may become entitled under this title. It shall be unlawful for any person to discharge, fine, suspend, expel, or discriminate against any individual because such individual has given information or has testified or is about to testify in any inquiry or proceeding relating to this title. The provisions of section 1301 shall be applicable in the enforcement of this section.

TRANSMITTAL OF INFORMATION; DUTIES OF THE SECRETARY OF HEALTH AND HUMAN SERVICES

SEC. 1307. (a) The Board shall transmit to the Secretary of Health and Human Services copies of the information contained in the annual report pursuant to section 1105(c)(4), and such other information insofar as it relates to the information described in section 1105(c)(4).

(b) The Board, after consultation with the Secretary of Health and Human Services, may prescribe such regulations as may be necessary to carry out the provisions of subsection (a).

(c) So much of section 1131 of the Social Security Act (42 U.S.C. 1320b–1) as precedes subsection (b) thereof is amended to read as follows:

"NOTIFICATION OF SOCIAL SECURITY CLAIMANT WITH RESPECT TO DEFERRED VESTED BENEFITS

"SEC. 1131. (a) Whenever—

"(1) the Secretary makes a finding of fact and a decision as to—

"(A) the entitlement of any individual to monthly benefits under section 202, 223, or 228,

"(B) the entitlement of any individual to a lump-sum death payment payable under section 202(i) on account of the death of any person to whom such individual is related by blood, marriage, or adoption, or

"(C) the entitlement under section 226 of any individual to hospital insurance benefits under part A of title XVIII, or

"(2) the Secretary is requested to do so—

"(A) by any individual with respect to whom the Secretary holds information obtained under section 6057 of the Internal Revenue Code of 1954 or under section 1307 of the Public Employee Retirement Income Security Act of 1981, or

"(B) in the case of the death of the individual referred to in subparagraph (A), by the individual who would be entitled to payment under section 204(d) of this Act,

the Secretary shall transmit to the individual referred to in paragraph (1) or the individual making the request under paragraph (2) any information, as reported by the administrator or the employer, regarding any deferred vested pension benefit transmitted to the Secretary pursuant to such section 6057 or such section 1307 with respect to the individual referred to in paragraph (1) or (2)(A) or the person on whose wages and self-employment income entitlement (or claim of entitlement) is based.".

ADVISORY COUNCIL ON GOVERNMENTAL PLANS

SEC. 1308. (a)(1) There is hereby established an Advisory Council on Governmental Plans (hereinafter in this section referred to as the "Council") consisting of eleven members appointed by the President. Not more than six members of the Council shall be members of the same political party. The President shall annually designate one member to serve as chairperson. The initial members of the Council shall be appointed no later than one hundred and twenty days after the date of the enactment of this title.

(2) Members shall be persons qualified to appraise the programs instituted under this title.

(3) As determined by the President, the members of the Council shall be representative of the employees, the employee organizations, the employers, and the general public having a direct interest in the plans covered under this title.

(4) Members shall serve for terms of three years except that of those first appointed, four shall be appointed for terms of one year, four shall be appointed for terms of two years, and three shall be appointed for terms of three years. A member may be reappointed. A member appointed to fill a vacancy shall be appointed only for the remainder of such term. A majority of members shall constitute a quorum and action shall be taken only by a majority vote of those present and voting. The Council shall meet at least twice each year

and at such other times as may be determined by the chairperson or as may be requested by the Board.

(b)(1) It shall be the duty of the Council to submit to the President and to each House of the Congress, no later than one year after the appointment of all initial members of the Council, a report which shall contain the Council's recommendations with respect to the initial implementation of the provisions of this title, together with recommendations for such amendatory or other legislation as the Council finds necessary.

(2) It shall further be the duty of the Council to advise the Board with respect to the carrying out of the Board's functions under this title and to submit to the Board recommendations with respect thereto. The Board shall actively consider any such recommendations of the Council prior to issuing regulations or otherwise carrying out its functions under this title. The Board shall include each recommendation which the Board has received from the Council during the preceding calendar year in the annual report to the Congress submitted pursuant to section 1309.

(c) The Council may establish voluntary guidelines for plans with respect to matters for which requirements are not established by this title. In establishing any such guidelines, the Council shall seek the advice of individuals and groups interested in such plans, including but not limited to employees, employee organizations, employers, administrators, and other interested persons, and may hold such hearings as it considers necessary in seeking such advice.

(d) The Board shall furnish to the Council an executive secretary and such professional, secretarial, clerical, and other services as the Board considers necessary for the Council to conduct its business. The Board shall call upon other agencies of the Government for statistical data, reports, and other information which the Council requests in the performance of its duties. The head of any such agency shall provide any data, report, or other information which is so requested.

(e) Members of the Council shall, for each day (including traveltime) during which they are attending meetings or conferences of the Council or otherwise engaged in the business of the Council, be compensated at a rate fixed by the Board which is not in excess of the daily equivalent of the annual rate of basic pay in effect for grade GS–18 of the General Schedule, and while away from their homes or regular places of business they may be allowed travel expenses, including per diem in lieu of subsistence, as authorized by section 5703 of title 5, United States Code.

(f) The Federal Advisory Committee Act (5 U.S.C. App.) shall not apply to the Council established by this section.

RESEARCH, STUDIES, AND ANNUAL REPORT

SEC. 1309. (a)(1) The Board is authorized to undertake research and surveys and in connection therewith to collect, compile, analyze and publish data, information, and statistics relating to plans, including but not limited to—

(A) the effects of this title upon the provisions and costs of plans,

(B) the role of pension plans in meeting the economic security needs of employees and their dependents, and

(C) the operation of pension plans including types and levels of benefits, degree of reciprocity or portability, financial and actuarial characteristics and practices, and methods of encouraging the growth of the pension system.

(2) The Board may, as the Board considers appropriate or necessary, undertake studies relating to pension and other employee benefit plans not subject to this title.

(3) The research, surveys, studies, and publications referred to in this subsection may be conducted directly or indirectly through grant or contract arrangements.

(b) The Board shall submit annually a report to the Congress covering the Board's administration of this title for the preceding year. The report shall include—

(1) an explanation of any exemptions under section 1102 and any actions taken under section 1115;

(2) the status of cases in enforcement status;

(3) recommendations received from the Advisory Council on Governmental Plans during the preceding year and an explanation of actions taken with respect thereto; and

(4) such information, data, research findings, studies, and recommendations in connection with the matters covered by this title as the Board may find advisable.

(c) The Board shall publish not less than annually a report which shall include, but shall not be limited to, the following:

(1) the number of plans (including an explanation of any increase or decrease in the number of plans since the publication of the previous report);

(2) the number of active and nonactive participants of such plans;

(3) the amount of plan assets, income (including but not limited to employee and employer contributions and investment income), and expenses (including but not limited to benefit payments);

(4) the amount of plan assets by investment category; and

(5) an analysis of the actuarial position of defined benefit plans.

The information required by this subsection shall be shown by type and size of plan.

EFFECT ON OTHER LAWS

SEC. 1310. (a) Except as provided in subsections (c) and (d), the provisions of sections 1203 through 1210 of this title shall supersede all laws of any State or any political subdivision of a State insofar as such laws may now or hereafter relate to the subject matter of such sections as they apply to any public employee pension benefit plan described in section 1003(a) and not exempt under section 1003(b).

(b) Except as provided in subsections (c) and (d) and in section 1102, the provisions of this title other than the provisions referred to in subsection (a) shall supersede all laws of any State or any political subdivision of a State, but only insofar as such laws (1) may now or hereafter relate to the subject matter of such provisions as they apply to any public employee pension benefit plan described in section 1003(a) and not exempt under section 1003(b), and (2) prevent the application of such provisions.

(c)(1) Nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

(2) For purposes of this subsection, neither a plan described in section 1003(a) which is not exempt under section 1003(b) nor any trust established under such a plan shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

(d) Subsections (a) and (b) shall not apply to any generally applicable criminal law of a State.

(e) For purposes of this section, the term "State law" includes all laws, decisions, rules, regulations, or other State action having the effect of law, of any State or political subdivision thereof. A law of the United States applicable only to the District of Columbia shall be treated as a State law rather than a law of the United States.

(f) Nothing in this title shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in subsection (e)) or any rule or regulation issued under any such law.

(g) This section shall not apply with respect to any cause of action which arose, or any act or omission which occurred, before the effective date set forth in section 1315(a).

AUTHORIZATION OF APPROPRIATIONS

SEC. 1311. There are hereby authorized to be appropriated such sums as may be necessary to enable the Board to carry out the Board's functions and duties under this title.

DISQUALIFICATION OF TRUSTS FORMING PART OF CERTAIN PLANS NOT MEETING REQUIREMENTS

SEC. 1312. Section 401 of the Internal Revenue Code of 1954 (relating to qualified pension, profit-sharing, and stock bonus plans) is amended—

(1) in subsection (a), by striking out "A trust" and inserting in lieu thereof "Except as provided in subsection (l), a trust";

(2) by redesignating subsection (l) as subsection (m); and

(3) by inserting after subsection (k) the following new subsection:

"(l) QUALIFICATION OF TRUSTS FORMING PARTS OF PLANS COVERED BY THE PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1981.—

"(1) GENERAL RULE.—In the case of a trust which forms a part of a public employee pension benefit plan (as defined in section 1002(26) of the Public Employee Retirement Income Security Act of 1981) to which such Act applies—

"(A) subsection (a) shall not apply to such trust; and

"(B) if such trust and the plan of which it forms a part meet the requirements of such Act, such trust shall be considered a qualified trust described in subsection (a) which is exempt from tax under section 501(a).

"(2) DETERMINATIONS BY THE BOARD.—Determinations under paragraph (1) shall be made by the Board. The Board shall make such determinations and certify such determinations to the Secretary as promptly as practicable.

"(3) RESORT TO AVAILABLE REMEDIES.—Any determination under paragraph (1) which disqualifies a trust under this subsection shall be made only if, after the application of all other remedies authorized by the Public Employee Retirement Income Security Act of 1981, the trust or the plan of which it is a part fails to comply with a requirement of such Act.

"(4) COOPERATION FROM THE BOARD.—The Board shall make available to the Secretary, upon request, any information, documents, returns, or other items in the possession of the Board relating to public employee pension benefit plans which the Secretary considers necessary to carry out the provisions of this section.".

TAX EXEMPTIONS WITH RESPECT TO PUBLIC EMPLOYEE PENSION BENEFIT PLANS

SEC. 1313. (a) Section 501(c) of the Internal Revenue Code of 1954 (relating to exemption from taxation of corporations, certain trusts, et cetera) is amended by adding at the end thereof the following new paragraph:

"(23)(A) A trust constituting a part of a public employee pension benefit plan (as defined in section 1002(28) of the Public Employee Retirement Income Security Act of 1981) to which such Act applies.

"(B) Determinations under subparagraph (A) shall be made by the Board. The Board shall make such determination and certify such determinations to the Secretary as promptly as practicable.".

(b) Section 503(a)(1)(B) of the Internal Revenue Code of 1954 (relating to denial of exemption to organizations engaged in prohibited transactions) is amended by inserting "and which is not referred to in section 4975(g)(4)" after "or (3)".

(c) Section 4975(g) of the Internal Revenue Code of 1954 (relating to application of tax on prohibited transactions) is amended—

(1) in paragraph (2), by striking out "or";

(2) in paragraph (3), by striking out "made." and inserting in lieu thereof "made; or"; and

(3) by inserting after paragraph (3) the following new paragraph:

"(4) to a public employee pension benefit plan described in section 501(c)(23).".

(d) Section 6058 of the Internal Revenue Code of 1954 (relating to information required in connection with certain plans of deferred compensation) is amended—

(1) by redesignating subsection (f) as subsection (g); and

(2) by inserting after subsection (e) the following new subsection:

"(f) EXCEPTION WITH REGARD TO PUBLIC EMPLOYEE PENSION BENEFIT PLANS.—This section shall not apply with respect to public employee pension benefit plans described in section 501(c)(23).".

SEVERABILITY

SEC. 1314. If any provision of this title, or the application of such provision to any person or circumstances, shall be held invalid, the remainder of this title, or the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

EFFECTIVE DATES

SEC. 1315. (a) Except as provided in subsections (b), (c), and (d), the preceding provisions of this title shall take effect at the beginning of the second calendar year following the date of the submission of the report by the Advisory Council on Governmental Plans pursuant to section 1308(b)(1).

(b) The provisions of this title authorizing the Board to promulgate regulations shall take effect on the date of the submission of the report by the Advisory Council on Governmental Plans pursuant to section 1308(b)(1).

(c) The provisions of sections 1002(18), 1305, 1306, 1308, 1311, and 1314 shall take effect on the date of the enactment of this title.

(d) Any actions, claims, or appeals which were filed or made under any provision of the Internal Revenue Code of 1954 amended by section 1312 or 1313 and are pending resolution at the beginning of the calendar year described in subsection (a) shall continue to be governed by such provision as in effect immediately before the beginning of such calendar year.

TITLE II—EMPLOYEE BENEFIT ADMINISTRATION

FINDINGS AND DECLARATION OF POLICY

SEC. 2001. (a) The Congress finds as follows:

(1) Multiple agency administration of the laws relating to employee benefit plans has—

(A) interfered with the free flow of commerce;

(B) prevented the development of a rational and coherent national policy relating to the provision of retirement income through public and private mechanisms;

(C) hindered the growth and development of more efficient and equitable systems for providing adequate retirement income to employees and their beneficiaries;

(D) impeded the timely and effective implementation of the provisions of the Employee Retirement Income Security Act of 1974 and the provisions of the Internal Revenue Code of 1954 relating to employee benefit plans;

(E) adversely affected the interests of plan participants, beneficiaries, and plan sponsors by creating unnecessary conflicts, complexity, confusion, and delay;

(F) resulted in unnecessary governmental costs and organizational waste and inefficiency, contrary to sound management principles; and

(G) created unnecessary burdens and costs for employee benefit plans, thus hindering their growth and expansion.

(2) It is therefore desirable and in the national interest and the interests of plan participants, beneficiaries, other employees, and plan sponsors to consolidate in a single independent agency certain administrative, regulatory, and policymaking functions relating to employee benefit plans.

(b) It is therefore declared to be the policy of this title to—

(1) foster the orderly growth and maintenance of employee benefit plans and enhance the free flow of commerce;

(2) protect more effectively the interests of participants and their beneficiaries in such plans; and

(3) promote the establishment of effective mechanisms for providing adequate retirement income to a greater number of persons;

through the development of a national policy by consolidating in a single independent agency the administration of laws relating to employee benefit plans, including the Employee Retirement Income Security Act of 1974 and certain provisions of the Internal Revenue Code of 1954 relating to employee benefit plans.

ESTABLISHMENT

SEC. 2002. (a) Subtitle A of title III of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1201 et seq.) is amended to read as follows:

"Subtitle A—Employee Benefit Administration

"ESTABLISHMENT

"SEC. 3001. (a) Not later than the beginning of the second calendar year after the date of the enactment of the Employee Benefit Administration Act of 1981, the President shall, by order, establish the Employee Benefit Administration (hereafter in this subtitle referred to as the 'Administration') as an independent agency within the executive branch of the Government.

"(b)(1)(A) There shall be at the head of the Administration a Board of Directors (hereafter in this subtitle referred to as the 'Board') which shall consist of—

"(i) the special liaison officer for the Department of Labor appointed under paragraph (2),

"(ii) the special liaison officer for the Department of the Treasury appointed under paragraph (3), and

"(iii) the Executive Director of the Administration, who shall serve as chairperson of the Board.

All functions of the Administration shall be vested in, and exercised by, the Board.

"(B) Except as otherwise provided in this subparagraph, members of the Board shall serve for terms of 6 years. The special liaison officer for the Department of Labor first appointed under paragraph (2) shall serve for a term of 4 years, and the special liaison officer for the Department of the Treasury first appointed under paragraph (3) shall serve for a term of 2 years.

"(C) A member of the Board may serve as a member of the Board after the expiration of the member's term until a successor has taken office as a member of the Board.

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

"(E) Not more than 2 members of the Board may be affiliated with the same political party.

"(F) Members of the Board shall be paid basic pay by the Administration at the rate of basic pay payable for level III of the Executive Schedule under section 5314 of title 5, United States Code.

"(G) All members of the Board shall be reimbursed for travel, subsistence, and other necessary expenses incurred in the performance of their functions as members of the Board.

"(2) There is established within the Office of the Secretary of Labor the position of special liaison officer to the Administration. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of Labor, shall serve for the term prescribed for such officer in paragraph (1), and shall be paid by the Administration as prescribed for such officer in such paragraph. The special liaison officer shall report regularly to the Secretary of Labor on the activities of the Administration.

"(3) There is established within the Office of the Secretary of the Treasury the position of special liaison officer to the Administration. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of the Treasury, shall serve for the term prescribed for such officer in paragraph (1), and shall be paid by the Administration as prescribed for such officer in such paragraph. The special liaison officer shall report regularly to the Secretary of the Treasury on the activities of the Administration.

"(4) There shall be in the Administration an Executive Director appointed by the President, by and with the advice and consent of the Senate, who shall serve for the term prescribed for the Executive Director in paragraph (1) and shall be paid as prescribed for the Executive Director in such paragraph.

"(5) There shall be in the Administration, in addition to the Executive Director, not more than 4 officers (including, but not limited to, 1 or more officers of the Pension Benefit Guaranty Corporation) who—

"(A) shall be appointed by the Board without regard to the provisions of title 5, United States Code, governing appointments in the competitive service; and

"(B) shall be paid basic pay at the rate payable for level IV or level V of the Executive Schedule under sections 5315 and 5316, respectively, of title 5, United States Code, as determined by the President, except that, in the case of an officer who holds any other position in the Federal Government, the pay payable to such officer under this paragraph shall be reduced (but not below zero) by the amount of the basic pay payable to such officer for such other position pursuant to any other provision of law.

"ADMINISTRATIVE PROVISIONS

"SEC. 3002. (a) The Board is authorized to prescribe such policies, standards, criteria, procedures, rules, and regulations as it deems necessary or appropriate to perform the functions vested in it.

"(b) Except as otherwise expressly provided by law, the Board may delegate any of its functions to such officers and employees of the Administration (and to officers or employees whose services are utilized under section 3004(f)) as it may designate, and may authorize such successive redelegations of such functions as it deems necessary or appropriate. The Board may organize the Administration as it deems necessary or appropriate and shall provide for efficient management and decisionmaking. The Board shall provide for a competent and qualified field force, so as to improve and not to diminish responsiveness on a local level of functions and duties vested in it.

"(c) The Board shall cause a seal of office to be made for the Administration of such design as it shall approve, and judicial notice shall be taken of such seal.

"(d) The Board may accept unconditional gifts or donations of money, services, or property, real, personal, or mixed, tangible or intangible.

"(e) The Board may enter into and perform contracts, leases, cooperative agreements, or other similar transactions with any public agency or instrumentality or with any person, firm, association, corporation, or institution.

"(f) The Board may perform such other activities as may be necessary for the effective fulfillment of its administrative functions.

"(g) The Board may appoint, employ, and fix the compensation of such officers and employees, including attorneys and actuaries, as are necessary to perform the functions vested in it, and prescribe their authority and duties.

"FUNCTIONS OF THE BOARD

"SEC. 3003. (a) In addition to the functions of the Board under this Act and the Public Employee Retirement Income Security Act of 1981, the functions of the Board include all functions relating to the qualification and disqualification of employee benefit plans under the Internal Revenue Code of 1954. Any determination by the Board or its delegate that a plan or trust is not qualified for purposes of such Code shall be made only if, after the application of all remedies other than disqualification authorized by this Act or by such Code, the plan or trust continues to fail to comply with the applicable requirements of such Code.

"(b)(1) In addition to those functions of the Board under this Act and the Internal Revenue Code of 1954 which are transferred to the Board in section 2003(a) of the Employee Benefit Administration Act of 1981, the functions of the Board shall include the administration and enforcement of those provisions the administration and enforcement of which are transferred to the Board pursuant to this subsection.

"(2) There are transferred to and vested in the Board the administration and enforcement of—

"(A) the Welfare and Pension Plan Disclosure Act (29 U.S.C. 301 et seq.), including all functions

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under such Act, to the extent that such Act continues to apply as provided in section 111(a)(1) and provides for administration and enforcement by the Secretary of Labor; and

"(B) those provisions of the Internal Revenue Code of 1954, set forth in sections 44G, 105(h), 120 (b), (c), and (d), 125, 219, 402, 403, 404, 405, 406 (c), (d), and (e), 407 (c), (d), and (e), 408, 409, 409A, 423, 457, 501(c) (9), (17), (18), (20), and (22), 503, 1379, 4972, 4975, 6058 (with respect to plans to which the provisions of part I of subchapter D of chapter 1 of such Code apply other than those plans described in section 401(a) of such Code), 6693, and 6699 of such Code, which are designated by the President under paragraph (3), including all functions under such designated provisions.

"(3) For purposes of the transfer required under paragraph (2)(B), on or before the date of the establishment of the Administration, the President shall designate those provisions relating to the formulation of policy with respect to employee benefit plans included in the sections referred to in paragraph (2)(B) and the implementation and enforcement of such sections, other than those provisions relating to execution of the collection of taxes.

"(4) The President shall, by order, transfer to and vest in the Board such additional functions of any department or agency of the United States as the President determines necessary to effectuate the maximum feasible consolidation in the Administration of all administrative and related functions (including enforcement) of the Federal Government relating to employee benefit plans.

"(c) In the case of any function transferred to the Board under subsection (b) or under section 2003 of the Employee Benefit Administration Act of 1981, all references in any provision of law to the Secretary of Labor, to the Secretary of the Treasury, or to the head of any agency referred to in subsection (a)(5) (or to any other person having the authority, before such transfer, to carry out such function) shall be deemed to be a reference to the Board, and all references to the Department of Labor, to the Department of the Treasury, or to a department or agency described in subsection (b)(4) with respect to any such function shall be deemed a reference to the Administration.

"(d) The Board shall prescribe regulations providing for the maximum consolidation of all reports with respect to employee benefit plans and governmental plans required to be provided pursuant to the provisions of this Act, the Public Employee Retirement Income Security Act of 1981, the Internal Revenue Code of 1954, or any other provision of law.

The Board may, by regulation, waive or modify any such report requirement if it has determined that such waiver or modification is necessary in order to effectuate the purposes of this subsection.

"COORDINATION BETWEEN AGENCIES

"SEC. 3004. (a) Notwithstanding sections 552 and 552a of title 5, United States Code, section 6103 of the Internal Revenue Code of 1954, or any other provision of law—

"(1) in carrying out its functions under this Act, the Public Employee Retirement Income Security Act of 1981, and the Internal Revenue Code of 1954, the Board shall notify the Secretary of the Treasury of any matter with respect to employee benefit plans and governmental plans which may affect the administration by the Secretary of provisions of such Code relating to such plans and to persons affected by such plans; and

"(2) in carrying out the Secretary's functions under such Code, the Secretary shall notify the Board of any matter with respect to employee benefit plans and governmental plans which may affect the administration by the Board of the provisions of this Act, the Public Employee Retirement Income Security Act of 1981, and such Code relating to such plans and to persons affected by such plans.

Any such matter of which the Board or the Secretary is notified under this subsection shall be subject to the same rules respecting confidentiality as those to which such matter would have been subject if the Board or the Secretary had not been so notified.

"(b) Notwithstanding sections 552 and 552a of title 5, United States Code, section 6103 of the Internal Revenue Code of 1954, or any other provision of law, the Secretary of the Treasury shall make available to the Board, upon request, any information, documents, returns, or other items in the Secretary's possession relating to employee benefit plans and governmental plans which the Board considers necessary to carry out its functions under this Act, the Public Employee Retirement Income Security Act of 1981, and the Internal Revenue Code of 1954, and the Board shall make available, upon request, to the Secretary any information, documents, reports, or other items relating to employee benefit plans and governmental plans which the Secretary considers necessary to carry out the Secretary's functions under such Code. Any such information, documents, returns, or other items made available under this subsection to the Board or to the Secretary shall be subject to the same rules respecting confidentiality as those to which such information, documents, returns, or other items would have been subject if they had not been so made available.

"(c) Whenever under this Act, the Public Employee Retirement Income Security Act of 1981, or the Internal Revenue Code of 1954 the Secretary of the Treasury and the Board are required to carry out provisions relating to the same subject matter (as determined by them), they shall consult with each other and shall develop rules, regulations, practices, and forms which, to the extent appropriate for the efficient administration of such provisions, are designed to reduce duplication of effort, duplication of reporting, conflicting or overlapping requirements, and the burden of compliance with such provisions by plan administrators, employers, and participants and beneficiaries.

"(d) In the case of any penalty or excise tax relating to employee benefit plans which may be imposed upon any person or plan under any provision of the Internal Revenue Code of 1954 the administration of which is transferred to the Board under section 3003(b) or under section 2003(a) of the Employee Benefit Administration Act of 1981, the Board shall determine whether such penalty or tax is owed and, if so, the amount due. After a determination of liability has been made, the Board shall certify the amount of that liability to the Secretary of the Treasury, who shall collect the amount so certified in the same manner and with the same powers as if the Employee Benefit Administration Act of 1981 had not been enacted. The Board may delay, reduce, or waive any such penalties or excise taxes relating to employee benefit plans.

"(e) Upon the request of the Secretary of the Treasury, the Board shall make a determination with respect to the qualification of any employee benefit plan and any governmental plan, and shall make any other determination under this Act, the Public Employee Retirement Income Security Act of 1981, or the Internal Revenue Code of 1954 which may be necessary to enable the Secretary to carry out the Secretary's functions under such Code. The Board shall make such determinations and notify the Secretary thereof as promptly as practicable.

"(f) In order to avoid unnecessary expense and duplication of functions among Government agencies, the Board may make such arrangements or agreements as it finds to be practicable and consistent with law to achieve cooperation or mutual assistance in the performance of its functions under this Act, the Public Employee Retirement Income Security Act of 1981, and the Internal Revenue Code of 1954 and the functions of any such agencies. The Board may utilize, on a reimbursable or other basis, the facilities or services of any department, agency, or establishment of the United States or of any State or political subdivision of a State, including the services of any of its officers and employees, with the lawful consent of such department, agency, or establishment. Each department, agency, or establishment of the United States shall cooperate with the Board and, to the extent permitted by law, provide such information and facilities as it may request for assistance in the performance of its functions under this Act, the Public Employee Retirement Income Security Act of 1981, and such Code. The Secretary of the Treasury and the Board shall transmit to the Attorney General of the United States or the Attorney General's representative for appropriate action such evidence developed in the performance of their functions under this Act, the Public Employee Retirement Income Security Act of 1981, and such Code in connection with employee benefit plans as may be found to warrant consideration for criminal prosecution under the provisions of this Act or other Federal law.

"(g) Before prescribing any regulations with respect to any activity which is the subject of any regulation under this Act, the Public Employee Retirement Income Security Act of 1981, or the Internal Revenue Code of 1954, other Federal departments, agencies, and establishments shall consult with the Administration with a view to avoiding unnecessary conflict, duplication, or inconsistency between the regulations of such agency and the regulations and other actions of the Administration.

"DEFINITIONS

"SEC. 3005. For purposes of this subtitle:

"(1) The term 'employee benefit plan' has the meaning set forth in section 3(3) (without regard to section 4).

"(2) The term 'governmental plan' has the meaning set forth in section 3(32) when used with respect to this Act, and has the meaning set forth in section 414(d) of the Internal Revenue Code of 1954 when used with respect to such Code.

"(3) The term 'function' includes any duty, obligation, power, authority, responsibility, right, privilege, activity, or program.

"AUTHORIZATION OF APPROPRIATIONS

"SEC. 3006. There are hereby authorized to be appropriated to the Administration such sums as may be necessary to enable the Board to carry out its functions and duties.".

(b) The items in the table of contents in section 1 of the Employee Retirement Income Security Act of 1974 relating to subtitle A of title III of the Employee Retirement Income Security Act of 1974 are amended to read as follows:

(c)(1) In the case of any function which may be transferred under section 3003(b) of the Employee Retirement Income Security Act of 1974 (as amended by this title) or section 2003(a) of this title, the provisions of such Act or any other law with regard to such function shall continue in force and effect until such time as such function is so transferred.

(2) The provisions of subsections (b) through (e) of section 3001 of the Employee Retirement Income Security Act of 1974 (as in effect immediately before the date of the enactment of this title) and of sections 3002 through 3004 of such Act (as so in effect) shall continue in force and effect until the date of the establishment of the Employee Benefit Administration.

(d) For purposes of this title, the term "function" includes any duty, obligation, power, authority, responsibility, right, privilege, activity, or program.

TRANSFERS TO THE BOARD OF DIRECTORS OF THE EMPLOYEE BENEFIT ADMINISTRATION

SEC. 2003. (a)(1) There are hereby transferred to and vested in the Board of Directors of the Employee Benefit Administration the administration and enforcement of—

(A) titles I, III, and IV of the Employee Retirement Income Security Act of 1974, including all functions under such titles, to the extent such titles provide for administration or enforcement by the Secretary of Labor or the Secretary of the Treasury; and

(B) sections 401, 406 (a) and (b), 407 (a) and (b), 410, 411, 412, 413, 414, 415, 418, 418A, 418B, 418C, 418D, 418E, 4971, 6057, 6058 (to the extent applicable to plans described in subsection (a) of such section 401), 6059, 6690, 6692, and 7476 of the Internal Revenue Code of 1954, including all functions under such sections.

(2) The Joint Board for the Enrollment of Actuaries is hereby redesignated as the "Actuary Enrollment Board" and is hereby transferred (together with all functions vested therein) to, and made a distinct entity of, the Employee Benefit Administration.

(3)(A) Section 4002(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1302(a)) is amended by striking out "within the Department of Labor" and inserting in lieu thereof "within the Employee Benefit Administration".

(B) Section 4002(d) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1302(c)) is amended—

(i) by striking out the first sentence and inserting in lieu thereof the following: "The board of directors of the corporation shall consist of the individuals who are members of the Board of Directors of the Employee Benefit Administration, and the chairperson of the board of directors shall be the individual who is the Chairperson of such Board."; and

(ii) by striking out the third sentence.

(4)(A) The transfers made by paragraphs (1) and (2) or by section 3003(b) of the Employee Retirement Income Security Act of 1974 (as amended by this title) shall take effect on the date on which the Administration is established, unless the President, by order, determines and provides in such order a later effective date with respect to any function the later transfer of which may be reasonably necessary. Any amendment made by section 2005 of this title to any provision of such Act or of the Internal Revenue Code of 1954 which reflects a transfer which is subject to such a later effective date shall take effect on such later effective date. In the case of any transfer of a function described in paragraph (2)(B) or (4) of section 3003(b) of such Act (as amended by this title), the President shall submit to each House of the Congress on the effective date of such transfer recommendations for amendatory legislation necessary to reflect in the law such transfer.

(B) Paragraph (3) and the amendments made by such paragraph shall take effect on the date on which the Administration is established.

(b) The President shall transfer to the Employee Benefit Administration—

(1) all officers and employees of the Department of Labor and the Department of the Treasury (includ-

ing officers and employees of the Internal Revenue Service) who are primarily engaged in functions transferred under paragraphs (1) and (2) of subsection (a) or under subtitle A of title III of the Employee Retirement Income Security Act of 1974 (as amended by this title); and

(2) all officers and employees of the Actuary Enrollment Board (as redesignated by subsection (a)(2)).

The President may also transfer such officers and employees of such departments and other departments and agencies as may be necessary to maintain and improve the administration of such functions and those functions transferred under section 3003(b)(4) of the Employee Retirement Income Security Act of 1974 (as amended by this title).

TRANSITIONAL AND SAVINGS PROVISIONS

SEC. 2004. (a) All orders, determinations, rules, regulations, directives, authorizations, designations, permits, contracts, certificates, licenses, privileges, and other actions—

(1) which have been issued, made, granted, or allowed to become effective by the Department of Labor, the Department of the Treasury, the Actuary Enrollment Board (as redesignated by section 2003(a)(2)), or any agency or official of the foregoing (or by any other agency or official the functions of which are transferred pursuant to section 3003(b)(4) of the Employee Retire-

ment Income Security Act of 1974 (as amended by this title)), or by a court of competent jurisdiction, in the performance of functions which are transferred under section 2003(a) or subtitle A of title III of the Employee Retirement Income Security Act of 1974 (as amended by this title); and

(2) which are in effect at the time such duties are transferred to the Employee Benefit Administration;

shall continue in effect according to their terms until modified, terminated, superseded, set aside, or revoked by the Board of Directors of the Administration, other authorized officials (including those of the Actuary Enrollment Board (as redesignated by section 2003(a)(2))), a court of competent jurisdiction, or by operation of law.

(b) Except as provided in subsection (e)—

(1) the provisions of section 2003(a) or of subtitle A of title III of the Employee Retirement Income Security Act of 1974 (as amended by this title) shall not affect any proceeding with respect to functions and duties transferred under section 2003(a) or such subtitle which are pending before any department or agency on or before the effective date of such transfer; and

(2) such proceedings shall be continued, orders shall be issued in such proceedings, appeals shall be

taken therefrom, and payments shall be made pursuant to such orders as if this title had not been enacted.

Orders issued in any such proceedings shall continue in effect until modified, terminated, superseded, or revoked by the Board of Directors of the Employee Benefit Administration, other authorized officials (including those of the Actuary Enrollment Board (as redesignated by section 2003(a)(2))), a court of competent jurisdiction, or by operation of law. Nothing in this subsection shall be deemed to prohibit the discontinuance or modification of any such proceeding under the same terms and conditions, and to the same extent, that such proceeding could have been discontinued or modified if this title had not been enacted.

(c) Except as provided in subsection (e), to the extent any suit which is commenced before the effective date of the transfer of any function under section 2003(a) or under subtitle A of title III of the Employee Retirement Income Security Act of 1974 (as amended by this title) relates to such function—

(1) the provisions of this title, including the amendments made by this title, shall not affect such suit, and

(2) in such suit proceedings shall be had, appeals taken, and judgments rendered, in the same manner and effect as if this title had not been enacted.

(d) No investigation, suit, action, or other proceeding commenced by or against any officer in the officer's official capacity as an officer of any department or agency, functions of which are transferred under section 2003(a) or under subtitle A of title III of the Employee Retirement Income Security Act of 1974 (as amended by this title), shall abate by reason of such transfer. No cause of action by or against any department or agency, functions of which are transferred under section 2003(a) or under subtitle A of title III of the Employee Retirement Income Security Act of 1974 (as amended by this title), or by or against any officer thereof in the officer's official capacity, shall abate by reason of such transfer. Causes of action, suits, actions, or other proceedings relating to any function transferred under section 2003(a) or under subtitle A of title III of the Employee Retirement Income Security Act of 1974 (as amended by this title) may be asserted by or against the United States or such official as may be appropriate and, in any litigation pending on the effective date of such transfer, the court may at any time, on its own motion or that of any party, enter any order which will give effect to the provisions of this subsection.

(e) If, on or before the effective date of the transfer of any function under section 2003(a) or under subtitle A of title III of the Employee Retirement Income Security Act of 1974 (as amended by this title), any department or agency, or officer thereof in the officer's official capacity, is a party to a proceeding referred to in subsection (b) or a suit referred to in subsection (c) and, under section 2003(a) or under such subtitle, any function of such department, agency, or officer is transferred to the Employee Benefit Administration or its Board of Directors, then such proceeding or suit, to the extent it related to such function on or before such date, shall be continued as if this title had not been enacted, with the Board or any appropriate officer thereof, as appropriate, substituted for such department, agency, or officer.

(f) The Director of the Office of Management and Budget shall make such additional incidental dispositions of personnel, personnel positions, assets, liabilities, contracts, property, records, and unexpended balances of appropriations, authorizations, allocations, and other funds held, used, arising from, available to, or to be made available in connection with functions which are transferred by or which revert under section 2003(a) or under subtitle A of title III of the Employee Retirement Income Security Act of 1974 (as amended by this title) as the Director considers necessary and appropriate to accomplish the intent and purpose of section 2003(a) and such subtitle.

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MISCELLANEOUS AND CONFORMING AMENDMENTS

SEC. 2005. (a)(1)(A) Section 3(13) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(13)) is amended to read as follows:

"(13) The term 'Board' means the Board of Directors of the Employee Benefit Administration or its delegate.".

(B) Except in the case of the provisions of title I of such Act specified in subsection (b), such title is amended by striking out "Secretary" each place it appears and inserting in lieu thereof "Board".

(C) Section 4001(a) of such Act (29 U.S.C. 1301(a)) is amended—

(i) in paragraph (11), by striking out "and";

(ii) in paragraph (12), by striking out "corporation." and inserting in lieu thereof "corporation;"; and

(iii) by adding at the end thereof the following new paragraph:

"(13) 'Board' means the Board of Directors of the Employee Benefit Administration or its delegate;".

(2)(A) Section 7701(a) of the Internal Revenue Code of 1954 (relating to definitions) is amended by adding at the end thereof the following new paragraph:

"(38) BOARD.—The term 'Board' means the Board of Directors of the Employee Benefit Administration or its delegate.".

(B) Section 7801(a) of such Code (relating to powers and duties of the Secretary of the Treasury) is amended to read as follows:

"(a) POWERS AND DUTIES OF SECRETARY.—

"(1) GENERAL RULE.—Except as provided in paragraph (2) and as otherwise expressly provided by law, the administration and enforcement of this title shall be performed by or under the supervision of the Secretary of the Treasury.

"(2) SPECIAL RULE FOR BOARD OF DIRECTORS OF THE EMPLOYEE BENEFIT ADMINISTRATION.—Except as provided in section 3004(d) of the Employee Retirement Income Security Act of 1974 and as otherwise expressly provided by law, the provisions of this title the administration and enforcement of which shall be performed by or under the supervision of the Board shall include—

"(A) sections 401, 406 (a) and (b), 407 (a) and (b), 410, 411, 412, 413, 414, 415, 418, 418A, 418B, 418C, 418D, 418E, 4971, 6057, 6058 (to the extent applicable to plans described in sections 401(a)), 6059, 6690, 6692, and 7476; and

"(B) those provisions of this title the administration and enforcement of which are transferred to the Board under section 3003(b) of the Employee Retirement Income Security Act of 1974.".

(C) Except in the case of the provisions of such Code specified in subsection (c), sections 401, 406(b), 407(b), 410, 411, 412, 413, 414, 415, 418, 418B, 418C, 418D, 418E, 6057, 6059, and 7476 of such Code are amended by striking out "Secretary" each place it appears and inserting in lieu thereof "Board".

(b) The Employee Retirement Income Security Act of 1974 is further amended—

(1) in section 3(14) (29 U.S.C. 1002(14)), by striking out "The Secretary, after consultation and coordination with the Secretary of the Treasury," and inserting in lieu thereof "The Board" and by striking out "Secretary" in the last sentence and inserting in lieu thereof "Board";

(2) in paragraphs (22), (27), (28), (29), (30), and (31) of section 3 (29 U.S.C. 1002 (22), (27), (28), (29), (30), and (31)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(3) in section 3(36) (29 U.S.C. 1002(36)), by striking out "Secretary of Labor" and inserting in lieu thereof "Board";

(4) in section 104(a)(1) (29 U.S.C. 1024(a)(1)), by striking out "Secretary" each place it appears and inserting in lieu thereof "Board" and by striking out "Department of Labor" and inserting in lieu thereof "Employee Benefit Administration";

(5) in section 104(a)(2)(A) (29 U.S.C. 1024(a)(2)(A)), by striking out "Department of Labor" and inserting in lieu thereof "Employee Benefit Administration";

(6) in section 106(a) (29 U.S.C. 1026(a)), by striking out "Secretary" each place it appears and inserting in lieu thereof "Board", by striking out "Department of Labor" and inserting in lieu thereof "Employee Benefit Administration", and by striking out "he" and inserting in lieu thereof "it";

(7) in section 109(a) (29 U.S.C. 1029(a)), by striking out "the Secretary", "him", and "he" and inserting in lieu thereof "the Board";

(8) in section 202(a)(2)(A)(ii) (29 U.S.C. 1052(a)(2)(A)(ii)), by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board under section 410 of the Internal Revenue Code of 1954";

(9) in section 203(a)(3)(D)(iii) (29 U.S.C. 1053(a)(3)(D)(iii)) by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board";

(10) in subparagraphs (C) and (G)(i)(II) of section 203(b)(1) (29 U.S.C. 1053(b)(1) (C) and (G)(i)(II)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(11) in section 203(c)(2) (29 U.S.C. 1053(c)(2)), by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board";

(12) in section 204(c)(2)(B)(ii) (29 U.S.C. 1054(c)(2)(B)(ii)), by striking out "Secretary of the Treasury or his delegate" and inserting in lieu thereof "Board";

(13) in section 204(c)(2)(D) (29 U.S.C. 1054(c)(2)(D)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(14) in section 204(d) (29 U.S.C. 1054(d)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(15) in section 205(h) (29 U.S.C. 1055(h)), by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board";

(16) in the last sentence of section 206(a) (29 U.S.C. 1056(a)), by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board";

(17) in subsections (b)(2), (c), and (d) of section 210 (29 U.S.C. 1060(b)(2), (c), and (d)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(18) in section 301(d) (29 U.S.C. 1081(d)), by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board";

(19) in paragraphs (4), (5), and (7)(A) of section 302(b) (29 U.S.C. 1082(b)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(20) in paragraphs (2)(A), (2)(B), (5), (9), and (10) of section 302(c) (29 U.S.C. 1082(c)(2) (A) and (B), (5), (9), and (10)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(21) in section 302(c)(8) (29 U.S.C. 1082(c)(8)), by striking out "the Secretary", "him", and "he" each place they appear and inserting in lieu thereof "the Board";

(22) in subsections (a), (c), and (d) of section 303 (29 U.S.C. 1083 (a) and (c)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(23) in section 407(d)(6)(B) (29 U.S.C. 1107(d)(6)(B)), by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board";

(24) in section 407(d)(7) (29 U.S.C. 1107(d)(7)), by striking out "Secretary" the first three places it appears and inserting in lieu thereof "Board" and by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board";

(25) in section 408(a) (29 U.S.C. 1108(a)), by striking out "Secretary" the first, third, fourth, and fifth places it appears and inserting in lieu thereof "Board" and by striking out the third sentence;

(26) in section 411(a) (29 U.S.C. 1111(a)), by striking out "Board" in the second sentence and inserting in lieu thereof "Board of Parole" and by striking out "Board's" in the third sentence and inserting in lieu thereof "Board of Parole's";

(27) in subsections (a) and (e) of section 412 (29 U.S.C. 1112 (a) and (e)), by striking out "Secretary" and "Secretary of the Treasury" each place they appear and inserting in lieu thereof "Board";

(28) by striking out section 502(b) (29 U.S.C. 1132(b)) and inserting in lieu thereof the following:

"(b) The Board shall not initiate an action to enforce section 515.";

(29) in section 502(j) (29 U.S.C. 1132(j)), by striking out "Secretary may represent" and all that follows down through the end thereof and inserting in lieu thereof "Board shall represent the Board in any court, State or Federal.";

(30) by striking out section 502(h) (29 U.S.C. 1132(h)) and inserting in lieu thereof the following:

"(h) A copy of the complaint in any action under this title by a participant, beneficiary, or fiduciary (other than an action brought by one or more participants or beneficiaries under subsection (a)(1)(B) which is solely for the purpose of recovering benefits due such participants under the terms of the plan) shall be served upon the Board by certified mail. The Board shall have the right in its discretion to intervene in any such action.";

(31) in section 502(k) (29 U.S.C. 1132(k)), by striking out "the Secretary" and "him" and inserting in lieu thereof "the Board";

(32) in section 504(a) (29 U.S.C. 1134(a)), by striking out "Secretary" the first four places it appears and inserting in lieu thereof "Board" and by striking out "he" and "him" each place they appear in paragraph (2) and inserting in lieu thereof "The Board";

(33) in section 504(c) (29 U.S.C. 1134(c)), by striking out "he", "the Secretary", and "his" and in-

serting in lieu thereof "the Board" and by inserting "(as in effect on November 1, 1981)" after "Federal Trade Commission Act";

(34) in section 507(c) (29 U.S.C. 1137(b)), by striking out "the Department of Labor or the Department of the Treasury" and inserting in lieu thereof "the Board";

(35) in section 513(a)(3) (29 U.S.C. 1143(a)(3)), by striking out "Secretary" and inserting in lieu thereof "Board" and by striking out "he" and inserting in lieu thereof "it";

(36) in section 513(b) (29 U.S.C. 1143(b)), by striking out "Secretary" and inserting in lieu thereof "Board", by striking out "his" and inserting in lieu thereof "its", and by striking out "he" and inserting in lieu thereof "it";

(37) in section 4001(a)(3)(C) (29 U.S.C. 1301(a)(3)(C)), by striking out "Secretary of Labor" and inserting in lieu thereof "Board";

(38) in section 4001(a)(11) (29 U.S.C. 1301(a)(11)), by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board";

(39) in section 4001 (29 U.S.C. 1301(b))—

(A) by inserting "(1)" after "(b)" in subsection (b);

(B) by striking out "Secretary of the Treasury under" and inserting in lieu thereof "Board under" in subsection (b);

(C) by striking all that follows subsection (b); and

(D) by adding at the end of subsection (b) the following new paragraphs:

"(2) For purposes of this title, 'single-employer plan' means, except as otherwise specifically provided in this title, any plan which is not a multiemployer plan.

"(3) For purposes of this title, except as otherwise provided in this title, contributions or other payments shall be considered made under a plan for a plan year if they are made within the period prescribed under section 412(c)(10) of the Internal Revenue Code of 1954.";

(40) by striking out section 4001(c)(4), by redesignating subsection (b) as subsection (b)(1), and by redesignating section 4001(c) (2) and (3) as section 4001(b) (2) and (3);

(41) in section 4021(a)(2) (29 U.S.C. 1321(a)(2)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(42) in subparagraphs (A) and (B) of section 4022(b)(6) (29 U.S.C. 1322(b)(6) (A) and (B)), by striking out "Secretary of the Treasury" and "Secretary"

each place they appear and inserting in lieu thereof "Board";

(43) in section 4044(b)(4) (29 U.S.C. 1344(b)(4)), by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board";

(44) in section 4065(a) (29 U.S.C. 1365(a)), by striking out "The corporation shall cooperate with the Secretary of the Treasury and the Secretary of Labor" and inserting in lieu thereof "The corporation shall coordinate its functions with those of the Board" and by striking out "such Secretaries" and inserting in lieu thereof "the Board";

(45) in section 4241 (29 U.S.C. 1421), by striking out "Secretary" and "Secretary of the Treasury" each place they appear and inserting in lieu thereof "Board";

(46) in subsections (c), (d), and (f) of section 4243 (29 U.S.C. 1423 (c), (d), and (f)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(47) in subsections (e) and (f) of section 4244 (29 U.S.C. 1424 (e) and (f)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(48) in subsections (a), (b), and (f) of section 4244A (29 U.S.C. 1425 (a), (b), and (f)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(49) in section 4244A(b)(2) (29 U.S.C. 1425(b)(2)), by striking out "Department of Labor" and inserting in lieu thereof "Employee Benefit Administration";

(50) in subsections (c) and (e) of section 4245 (29 U.S.C. 1426 (c) and (e)), by striking out "Secretary of the Treasury" each place it appears and inserting in lieu thereof "Board";

(51) in section 4281(c)(2) (29 U.S.C. 1441(c)(2)), by striking out "Secretary of the Treasury" and inserting in lieu thereof "Board"; and

(52) in section 4301(a)(2) (29 U.S.C. 1451(a)(2)), by striking out "the Secretary of the Treasury, the Secretary of Labor, or" and inserting in lieu thereof "the Board or".

(c) The Internal Revenue Code of 1954 is further amended—

(1) in subparagraphs (B) and (C) of section 404(a)(1), by striking out "Secretary of Labor" and "Secretary" each place they appear and inserting in lieu thereof "Board";

(2) in subparagraphs (A), (B), (C), and (D) of section 410(a)(3), by striking out "Secretary of Labor" each place it appears and inserting in lieu thereof "Board";

(3) in subparagraphs (A) and (B) of section 410(b)(3), by striking out "Secretary of Labor" each place it appears and inserting in lieu thereof "Board";

(4) in section 411(a)(3)(B), by striking out "Secretary of Labor" and inserting in lieu thereof "Board";

(5) in subparagraphs (A), (C), and (D) of section 411(a)(5), by striking out "Secretary of Labor" each place it appears and inserting in lieu thereof "Board";

(6) in section 411(a)(6)(A), by striking out "Secretary of Labor" and inserting in lieu thereof "Board";

(7) in subparagraphs (A), (C), (D), and (E) of section 411(b)(3), by striking out "Secretary of Labor" each place it appears and inserting in lieu thereof "Board";

(8) in section 412(c)(8), by striking out "the Secretary of Labor", "him", and "he" each place they appear and inserting in lieu thereof "the Board";

(9) in section 412(e), by striking out "the Secretary of Labor" and "he" each place they appear and inserting in lieu thereof "the Board";

(10) in section 412(f)(2)(A), by striking out "Secretary of Labor" and inserting in lieu thereof "Board";

(11) in section 413(a)(1), by striking out "Secretary of Labor" and inserting in lieu thereof "Board";

(12) in section 413(b)(4), by striking out "Secretary of Labor" and inserting in lieu thereof "Board";

(13) in section 413(c)(3), by striking out "Secretary of Labor" and inserting in lieu thereof "Board";

(14) in section 414(f)(1)(C), by striking out "Secretary of Labor" and inserting in lieu thereof "Board";

(15) in section 418D(b)(2), by striking out "Department of Labor" and inserting in lieu thereof "Employee Benefit Administration";

(16) in section 4971, by striking out subsection (d) and by redesignating subsection (e) as subsection (d);

(17) in section 4975(c)(2), by striking out "Secretary" the first, third, fourth, and fifth places it appears and inserting in lieu thereof "Board", by striking out "he" each place it appears and inserting in lieu thereof "it", by striking out the third sentence, and by striking out "Secretary of Labor" in the last sentence and inserting in lieu thereof "Board";

(18) in section 6057, by striking out subsection (d).

(19) in section 6057(f)(1), by striking out "Secretary," and inserting in lieu thereof "Board,";

(20) in section 7476(b)(1), by striking out "Secretary" and inserting in lieu thereof "Board" and by striking out "Internal Revenue Service" and inserting in lieu thereof "Employee Benefit Administration";

(21) in section 7476(b)(3), by striking out "Internal Revenue Service" and inserting in lieu thereof "Employee Benefit Administration";

(22) in section 7476(b)(5), by striking out "Secretary" and inserting in lieu thereof "Board" and by striking out "his" the first place it appears and inserting in lieu thereof "its"; and

(23) in section 7476, by striking out subsection (d).

(d)(1) Sections 101(d) and 104(d) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1021(d), 1024(d)) are each amended by striking out "to the Secretaries of Labor and the Treasury, see section 3004" and inserting in lieu thereof "under this and other provisions of law, see section 3003(d)".

(2)(A) Section 512(a)(1) of such Act (29 U.S.C. 1142(a)(1)) is amended by striking out "Secretary" and inserting in lieu thereof "Board of Directors of the Employee Benefit Administration".

(B) The amendment made by subparagraph (A) shall apply with respect to members appointed to the Advisory Council on Employee Welfare and Pension Benefit Plans on or after the date of the establishment of the Employee Benefit Administration. Each member appointed to such Council before such date shall continue in office until the expiration of the member's term.

(3) Section 1033(c) of such Act is repealed.

(4)(A) Section 3041 of such Act (29 U.S.C. 1241) is amended to read as follows:

"ACTUARY ENROLLMENT BOARD

"SEC. 3041. There is within the Employee Benefit Administration the Actuary Enrollment Board (as redesignated in section 2003(a) of the Employee Benefit Administration Act of 1981).".

(B) Section 3042 of such Act (29 U.S.C. 1242) is amended by striking out "Joint Board" each place it appears (including the heading) and inserting in lieu thereof "Actuary Enrollment Board".

(C) The table of contents in section 1 of such Act is amended by striking out the items relating to sections 3041 and 3042 and inserting in lieu thereof the following new items:

"Sec. 3041. Actuary Enrollment Board.
"Sec. 3042. Enrollment by Actuary Enrollment Board.".

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(D) Section 7701(a)(35) of the Internal Revenue Code of 1954 (defining enrolled actuary) is amended by striking out "Joint Board for the Enrollment of Actuaries established under" and inserting in lieu thereof "Actuary Enrollment Board described in".

(e)(1) Section 4971(d) of the Internal Revenue Code of 1954 (as redesignated by subsection (c) of this section) is amended by striking out the third sentence thereof and inserting in lieu thereof the following:

"For provisions relating to the delay, reduction, or waiver of the tax imposed under this subsection and the coordination of functions and duties under this section between the Board and the Secretary, see section 3004(d) of the Employee Retirement Income Security Act of 1974."

(2) Section 4975(i) of such Code is amended to read as follows:

"(i) CROSS REFERENCE.—

"For provisions permitting the delay, reduction, or waiver of the tax imposed by subsection (b) and the coordination of functions and duties under this section between the Board and the Secretary, see section 3004(d) of the Employee Retirement Income Security Act of 1974."

(3) Section 6057(g) of such Code is amended by striking out the second sentence.

(4) Section 6058(a) of such Code is amended to read as follows:

"(a) IN GENERAL.—Every employer who maintains a pension, annuity, stock bonus, profit sharing, or other funded plan of deferred compensation described in part I of subchapter D of chapter 1, or the plan administrator (within the meaning of section 414(g)) of the plan, shall—

"(1) in the case of any such plan described in section 401(a), file an annual return with the Board stating such information as the Board may by regulations prescribe, or

"(2) in the case of any other such plan, file an annual return with the Secretary stating such information as the Secretary may by regulations prescribe,

with respect to the qualification, financial condition, and operations of the plan; except that, in the discretion of the Board or the Secretary (as applicable), the employer may be relieved from stating in its return any information which is reported in other returns.".

(5) Section 6058(f) of such Code is amended—

(A) by striking out "coordination between the Department of the Treasury and the Department of Labor" and inserting in lieu thereof "consolidation of reporting requirements under this and other provisions of law"; and

(B) by striking out "3004" and inserting in lieu thereof "3003".

(6) Section 6059 of such Code is amended by striking out subsection (d).

(7) Section 6103(l)(2) of such Code is amended—

(A) in the catchline, by striking out "DEPARTMENT OF LABOR" and inserting in lieu thereof "EMPLOYEE BENEFIT ADMINISTRATION";

(B) by striking out "Department of Labor" and inserting in lieu thereof "Employee Benefit Administration"; and

(C) by striking out "titles I and IV" and inserting in lieu thereof "title I, subtitle A of title III, and title IV".

(f) Except as provided in section 2003(a)(4)(A), the amendments made by this section shall take effect on the date of the establishment of the Employee Benefit Administration.

97TH CONGRESS
2D SESSION

S. 2106

To provide for pension reform for State and local public employee retirement systems, and for other purposes.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 11 (legislative day, JANUARY 25), 1982

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

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A BILL

To provide for pension reform for State and local public employee retirement systems, and for other purposes.

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

SHORT TITLE AND TABLE OF CONTENTS

SECTION 1. This Act may be cited as the "Public Employee Retirement Income Security Act of 1981".

TABLE OF CONTENTS

FINDINGS AND DECLARATION OF POLICY

SEC. 2. (a) The Congress finds as follows:

(1) The growth in the size and scope of public employee pension benefit plans has been rapid and sub-

stantial, and a large volume of the activities of such plans is carried on by the mails and instrumentalities of interstate commerce.

(2) Many State and local governments rely heavily on Federal funds to help meet pension costs. The maintenance and growth of such plans has a substantial and growing impact on Federal revenues.

(3) Millions of employees and their families depend on these plans for their financial well-being and security, and such plans are an important factor affecting the stability of employment. The interests of participants in such plans are in the nature of property rights.

(4) The lack of adequate standards of conduct and responsibility for fiduciaries of such plans, the arbitrary and unreasonable application of rules affecting plan operations, and the inadequate safeguards of plan assets result in a denial to participants of due process and equal protection of the laws and impair the economic security of plan participants and their beneficiaries.

(5) The investment of plan assets and the distribution of plan benefits have a substantial impact on the national economy, affecting capital formation, regional growth and decline, and the markets for securities. The financial status of such plans has a direct impact on

the markets for securities of State and local governments.

(6) Many jurisdictions do not systematically fund retirement benefits accruing to their employees. Public pensions are becoming a large financial burden on State and local governments and that burden will increase in the future.

(7) Disclosure to the general public, the responsible governments, and plan participants and their dependents about the financial status and operations of such plans and the rights of plan participants is inadequate. The lack of meaningful disclosure affects the financial stability of public employee pension benefit plans and their sponsoring governments, impairs the rights of plan participants, and constitutes a serious threat to the future economic health of the Nation.

(8) Public employee pension benefit plans have a substantial impact on interstate commerce as a consequence of the interstate nature of their financial and other activities and the interstate movement of participants. The lack of meaningful financial disclosure and standards of conduct and responsibility for fiduciaries of such plans, and the failure to fully inform participants and beneficiaries of their rights substantially impede the free flow of commerce.

(9) Public employee pension benefit plans are affected with a national public interest. It is necessary and desirable in order to protect the rights of plan participants and their beneficiaries and provide for the general welfare and the free flow of commerce, that meaningful disclosure be made and standards of conduct and responsibility be provided with respect to the establishment, operation, and administration of such plans.

(b) It is therefore declared to be the policy of this Act to protect the interests of participants and beneficiaries in public employee pension benefit plans and the interests of the Federal Government and the general public in the operation of such plans and to minimize the possible adverse impact of the operations of such plans on Federal revenues and expenditures and the national securities markets, by requiring the disclosure and reporting to participants and their beneficiaries, employers, employee organizations, and the general public of financial and other information about such plans, by establishing standards of conduct and responsibility for fiduciaries of public employee pension benefit plans, and by providing for appropriate remedies, sanctions, and access to the Federal courts.

DEFINITIONS

SEC. 3. For purposes of this Act—

(1) The term "accumulated plan benefit" means—

(A) in the case of a defined benefit plan, that portion of a participant's retirement benefit that is attributable, pursuant to the terms of the plan and in accordance with regulations of the Secretary, to the participant's period of credited service prior to the date of determination, and

(B) in the case of an individual account plan, the balance of the participant's account on the date of determination.

(2) The term "actuarial present value" means the single amount as of a given valuation date that results from applying actuarial assumptions to an amount or series of amounts payable or receivable at various times. Such amount or amounts shall be adjusted as appropriate to reflect—

(A) expected changes from the valuation date to the date of expected payment or receipt by reason of expected salary changes, cost-of-living adjustments, or other changes; and

(B) the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment or receipt.

(3) The term "actuarial valuation method" means a procedure, using actuarial assumptions, for measuring the expected value of plan benefits and assigning such value to time periods.

(4) The term "actuarial value of assets" means the value assigned by the actuary to the assets of a plan for the purposes of an actuarial valuation performed under section 109.

(5) The term "adequate consideration" means—

(A) in the case of a security for which there is a generally recognized market, either—

(i) the price of the security prevailing on a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934, or

(ii) if the security is not traded on such a national securities exchange, a price not less favorable to the plan than the offering price for the security as established by the current bid and asked prices quoted by persons independent of the issuer and of any party in interest; and

(B) in the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Secretary.

(6) The term "administrator" means—

(A) the board of trustees, retirement board, or similar person with administrative responsibilities in connection with a plan, or any other person specifically so designated in connection with any requirement of this Act by the terms of the instrument or instruments under which the plan is operated, including but not limited to the law of any State or of any political subdivision of any State;

(B) in any case in which there is no person described in subparagraph (A) in connection with the plan, the plan sponsor; and

(C) in any case in which there is no entity described in subparagraph (A) in connection with the plan and a plan sponsor cannot be identified, such other person as the Secretary may by regulation prescribe.

(7) The term "annual actuarial value" means that part of the actuarial present value of all future benefit payments and appropriate administrative expenses assigned to each year, or other period, under the actuarial valuation method used by the plan (excluding any amortization of the unfunded supplemental actuarial value).

(8) The term "beneficiary" means a person designated by a participant, or by the terms of a public employee pension benefit plan, who is or may become entitled to a benefit thereunder.

(9) The term "combined actuarial value" means the sum of the annual actuarial value and that portion of the unfunded supplemental actuarial value assigned, usually by an amortization process, to the current period.

(10) The term "current value" means the fair market value, if available, or, if a fair market value is not available, the fair value as determined in good faith by a trustee or a named fiduciary pursuant to the terms of the plan and in accordance with regulations of the Secretary, assuming an orderly liquidation at the time of such determination.

(11) The term "defined benefit plan" means a plan other than an individual account plan; except that

a plan which is not an individual account plan and which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant shall, for the purposes of paragraph (1) of this section, be treated as—

(A) an individual account plan to the extent benefits are based upon the separate account of a participant, and

(B) a defined benefit plan with respect to the remaining portion of benefits under the plan.

(12) The term "employee" means any individual employed by an employer, employer representative, or other person required to make employer contributions under the plan.

(13) The term "employee organization" means any labor union or any organization of any kind, or any agency or employee representation committee, association, group, or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers or employer representatives concerning a public employee pension benefit plan or other matters incidental to employment relationships; or any employees' beneficiary association organized for the purpose, in whole or in part, of establishing such a plan.

(14) The term "employer" means—

(A) the government of any State or of any political subdivision of any State; and

(B) any agency or instrumentality of a State or of a political subdivision of a State.

(15) The term "employer contribution" means any contribution to a public employee pension benefit plan other than a contribution made by a participant in the plan.

(16) The term "employer representative" means—

(A) any group or association consisting, in whole or in part, of employers acting, in connection with a public employee pension benefit plan, for an employer; and

(B) any person acting, in connection with a public employee pension benefit plan, indirectly in the interest of an employer or of a group or association described in subparagraph (A).

(17) The term "enrolled actuary" means an actuary enrolled by the Joint Board for the Enrollment of Actuaries in accordance with section 3042 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1242), except that, with respect to individuals applying for enrollment during the one-year period fol-

lowing the date of the enactment of this Act who certify to the Joint Board, in a manner which shall be prescribed by the Joint Board, that they are applying only for the purpose of performing actuarial services with respect to plans to which this Act applies, paragraphs (1) and (2) of subsection (a) of such section 3042 shall not apply, and the standards and qualifications required by the Joint Board shall include a requirement for an appropriate period of responsible actuarial experience relating to public employee pension benefit plans. References in such section 3042 to the Employee Retirement Income Security Act of 1974 shall be construed to also refer to this Act.

(18)(A) Except as otherwise provided in subparagraph (B), the term "fiduciary" means, in connection with a plan, any person to the extent that—

(i) such person exercises any discretionary authority or discretionary control with respect to management of such plan or exercises any authority or control with respect to management or disposition of its assets;

(ii) such person renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so; or

(iii) such person has any discretionary authority or discretionary responsibility in the administration of such plan.

Any person designated under section 202(c)(4) is a fiduciary.

(B) If any money or other property of a plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a fiduciary, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with a public employee pension benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

(19) The term "individual account plan" means a plan which provides for an individual account for each participant and for benefits based solely upon the

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amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

(20) The term "investment manager" means, in connection with a plan, any person who is a fiduciary with respect to the plan (other than a trustee or named fiduciary)—

(A) who has the power to manage, acquire, or dispose of any asset of the plan;

(B) who is either—

(i) registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.);

(ii) a bank, as defined in that Act; or

(iii) an insurance company qualified to perform services described in subparagraph (A) under the laws of more than one State; and

(C) who has acknowledged in writing that such person is a fiduciary with respect to the plan.

(21) The term "named fiduciary" means a person who is designated a named fiduciary in accordance with section 202(a).

(22) The term "participant" means any individual who is or may become eligible to receive a benefit of any type from a public employee pension benefit plan or whose beneficiaries may be eligible to receive any such benefit.

(23)(A) Except as provided in subparagraph (B), the term "party in interest", with respect to a public employee pension benefit plan, means—

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

(ii) a person providing services to such plan;

(iii) an employer or employer representative any of whose employees are covered by such plan;

(iv) an employee organization any of whose members are covered by such plan;

(v) a relative (as defined in paragraph (28)) of any individual described in clause (i) or (ii); and

(vi) an individual (earning 10 percent or more of the yearly wages of the person employing the individual) employed by, or an officer or director (or an individual having powers or duties similar to those of officers or directors) of—

(I) a person described in clause (ii), (iii), or (iv), or

(II) such plan.

(B) If any money or other property of a plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.), such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a party in interest, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with a public employee pension benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

(24) The term "person" means a State, a political subdivision of a State, any agency or instrumentality of a State or a political subdivision of a State, an individual, a partnership, a joint venture, a corporation, a mutual company, a joint-stock company, a trust, an estate, an unincorporated organization, an association, or an employee organization.

(25) The term "plan sponsor" means—

(A) in the case of a plan established or maintained solely for employees of a single employer, such employer;

(B) in the case of a plan established or maintained by an employee organization, the employee organization; and

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

(26) The term "plan year" means, with respect to a plan, the calendar, policy, or fiscal year on which the records of the plan are kept.

(27) The terms "public employee pension benefit plan" and "plan" mean any plan, fund, or program which was heretofore or is hereafter established or maintained, in whole or in part, by an employer, an employer representative, or an employee organization, or by a combination thereof, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program—

(A) provides retirement income to employees, or

(B) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond,

regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan, or the method of distributing benefits from the plan.

(28) The term "relative" means a brother, sister, spouse of a brother or sister, spouse, ancestor, lineal descendant, or spouse of a lineal descendant.

(29) The term "Secretary" means the Secretary of Labor.

(30) The term "security" has the same meaning as such term has under section 2(1) of the Securities Act of 1933 (15 U.S.C. 77b(1)).

(31) The term "separate account" means an account established or maintained by an insurance company under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such accounts without regard to other income, gains, or losses of the insurance company.

(32) The term "State" means any State of the United States, the District of Columbia, the Common-

wealth of Puerto Rico, the Virgin Islands, American Samoa, and Guam. The term "United States" when used in the geographic sense means the States and the Outer Continental Shelf lands defined in the Outer Continental Shelf Lands Act (43 U.S.C. 1331–1343).

(33) The term "supplemental actuarial value" means the actuarial present value of all future benefit payments and appropriate administrative expenses under a plan reduced by the actuarial present value of all future annual actuarial values (including any participants' contributions) with respect to the participants included in the actuarial valuation of the plan.

(34) The term "unfunded supplemental actuarial value" means the excess of the supplemental actuarial value over the actuarial value of assets of a plan.

(35) The term "vested pension benefit" means an interest obtained by a participant or beneficiary in that part of an immediate or deferred benefit under a plan which—

(A) arises from the participant's service and which is not conditional upon the participant's continued service for an employer or employer representative employing one or more participants in the plan, and

(B) has not been forfeited under the terms of the plan.

COVERAGE

SEC. 4. (a) Except as provided in subsection (b), this Act shall apply to any public employee pension benefit plan.

(b) The provisions of this Act shall not apply to—

(1) any employee benefit plan described in section 4(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1003(a)), which is not exempt under section 4(b)(1) of such Act (29 U.S.C. 1003(b)(1));

(2) any plan which is unfunded and is maintained by an employer or employer representative primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees;

(3) any severance pay plan, as defined in regulations by the Secretary;

(4) any agreement to the extent it is a coverage agreement entered into pursuant to section 218 of the Social Security Act (42 U.S.C. 418);

(5) any individual retirement account or an individual retirement annuity within the meaning of section 408, or a retirement bond within the meaning of section 409, of the Internal Revenue Code of 1954;

(6) any plan described in section 401(d) of such Code;

(7) any individual account plan consisting of an annuity contract described in section 403(b) of such Code;

(8) any eligible State deferred compensation plan, as defined by section 457(b) of such Code; or

(9) any plan maintained solely for the purpose of complying with applicable workers' compensation laws or disability insurance laws.

TITLE I—REPORTING AND DISCLOSURE

DUTY OF DISCLOSURE AND REPORTING

SEC. 101. (a) Except as provided in subsection (b), each administrator shall submit a registration statement to the Secretary not more than one-hundred-and-twenty days after the effective date set forth in section 312(a). Such registration statement shall provide the name and address of the plan and its administrator, and such other information relating to the characteristics and identity of the plan as the Secretary considers necessary in order to determine the extent to which the provisions of this Act apply to such plan. The Secretary shall issue regulations to implement the provisions of this paragraph.

(b) Subsection (a) shall not apply to a plan in any case in which the registration statement required under section 6057 of the Internal Revenue Code of 1954 with respect to the plan has been filed by its administrator during the two-year period ending on the last day of the one hundred and twenty-day period described in such subsection and such registration statement continues to accurately reflect the status of the plan.

EXEMPTION FOR PLANS MEETING MINIMUM STANDARDS UNDER STATE LAW

SEC. 102. (a) Any requirement of this title or section 212, 301(b), or 306 shall not apply to a plan governed by the law of any State or of a political subdivision of any State to the extent that the Secretary determines that—

(1) such law governing the plan applies a requirement to the plan substantially equivalent to the requirement of this title or such section;

(2) there is adequate provision for administration by the State or political subdivision of its requirement referred to in paragraph (1); and

(3) the State or political subdivision has adequate means to collect the annual reports required under its law and will collect such reports and provide them to the Secretary.

(b) A State or a political subdivision of a State may apply for a determination of the Secretary under this section that the requirements of subsection (a) have been met with respect to any of the provisions of this title and sections 212, 301(b), and 306.

SUMMARY PLAN DESCRIPTION

SEC. 103. (a)(1) The administrator of each public employee pension benefit plan shall publish a summary plan description with respect to every plan to which this Act applies. The summary plan description shall include the information required under subsection (b). The summary plan description, a summary of any material modification in the terms of the plan and any other change in the information required under subsection (b), and any updated summary plan description required under subsection (c) shall be furnished to participants, beneficiaries, and other persons in the manner and to the extent provided in section 110.

(2) The summary plan description and any other summary description required by this title shall be written in a manner calculated to be understood by the average plan participant and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and their beneficiaries of their rights and obligations under the plan.

(b) The summary plan description shall contain the following information:

(1) the name of the plan and the type of administration;

(2) the name and address of the person designated as agent for the service of legal process, if such person is not the administrator;

(3) the name and address of the administrator;

(4) the names, titles, and addresses of any trustee or trustees (if they are persons different from the administrator);

(5) a description of the relevant provisions of any applicable collective bargaining agreement;

(6) citations to the relevant provisions of State and local law and regulations governing the establishment, operation, and administration of the plan;

(7) the plan's requirements with respect to eligibility for participation and benefits;

(8) a description of those provisions which specify the conditions under which pension benefits under the plan become vested pension benefits;

(9) the circumstances which may result in disqualification, ineligibility, or denial or loss of benefits;

(10) the source of financing of the plan and the identity of any organization through which benefits are provided;

(11) the date of the end of the plan year and whether the records of the plan are kept on a calendar, policy, or fiscal year basis; and

(12) the procedures to be followed in presenting claims for benefits under the plan and the remedies available under the plan for the redress of claims which are denied in whole or in part (including procedures required under section 114 of this Act).

(c) The summary plan description shall include a statement of the rights of participants and beneficiaries under this Act.

(d)(1) The administrator of each plan shall publish a summary description of any material modification in the terms of the plan and any other change in the information required under subsection (b) not later than two hundred and ten days after the end of the plan year in which the modification or other change is adopted, or within such time as the Secretary may prescribe by regulation.

(2)(A) Except as provided in subparagraph (B), in any case in which a plan is amended, the administrator of the plan shall update its summary plan description within 10 years after the date of adoption of the amendment by integrating the amendment into such description.

(B) In any case in which a plan amendment referred to in subparagraph (A) has the effect of curtailing or reducing benefits or further restricting entitlement thereto, the administrator of the plan shall update the summary plan description by integrating the amendment into such description within five years after the earlier of the date of adoption or the effective date of the amendment.

(3) The summary of modifications and changes and the updated summary plan description required by this subsection shall be distributed to participants and beneficiaries as provided in section 110.

ANNUAL REPORT

SEC. 104. (a)(1) The administrator of each public employee pension benefit plan to which this Act applies shall publish an annual report for each plan year. Such report shall include the information and statements described in sections 105 and 106 and, as applicable, sections 107 and 108.

(2) The administrator shall file the annual report with the Secretary in accordance with section 112 and shall make available and furnish the report to participants, beneficiaries, and other persons as provided in section 110.

(3) In addition to the information otherwise required by this title in the annual report, the administrator may include in the annual report a statement or statements relating to any matter contained in the annual report.

(b)(1) If some or all of the information necessary to enable the administrator to comply with the requirements of this title is maintained by—

(A) an insurance carrier or other organization which provides some or all of the benefits under the plan, or holds assets of the plan in a separate account,

(B) a bank or similar institution which holds some or all of the assets of the plan in a common or collective trust or a separate trust, or custodial account, or

(C) the plan sponsor,

such carrier, organization, bank, institution, or plan sponsor shall transmit and certify the accuracy of such information to the administrator within one hundred and twenty days after the end of the plan year covered by the annual report (or such other date as may be prescribed under regulations of the Secretary).

(2)(A) The Secretary shall by regulation prescribe simplified annual reports for any plan which covers fewer than one hundred participants.

(B) Nothing contained in this subsection shall preclude the Secretary from revoking provisions for simplified reports for any such plan if the Secretary finds it necessary to do so in order to carry out the objectives of this Act.

GENERAL INFORMATION INCLUDED IN ANNUAL REPORT

SEC. 105. The annual report shall include the following information:

(1) the name of the plan, and any change in the name of the plan;

(2) the name and address of the administrator, and any change in the name or address of the administrator;

(3) the name and address of the person designated as agent for the service of legal process, if such person is not the administrator;

(4)(A) the name and taxpayer identifying number of each participant in the plan—

(i) who in the year preceding the plan year for which such annual report is filed, separated from service covered by the plan,

(ii) who did not return to service covered by the plan by the end of the plan year for which such annual report is filed,

(iii) who is entitled to a vested pension benefit under the plan or to the return of employee contributions, and

(iv) with respect to whom benefits were not paid under the plan during the plan year for which the annual report is filed or the plan year preceding such plan year;

(B) the nature, amount, and form of any benefits to which each participant described in subparagraph (A) is entitled, including but not limited to the contributions made by such participant, if any, and interest on such contributions, if any;

(5) the name and address of each fiduciary with respect to the plan;

(6) the number of employees covered by the plan;

(7) except in the case of a person whose compensation is minimal (determined under regulations of the Secretary) and who performs solely ministerial duties (determined under such regulations), the name of each person (including but not limited to any consultant, broker, trustee, attorney, accountant, insurance carrier, actuary, administrator, investment manager, or custodian) who received compensation directly or indirectly from the plan during the plan year for which the annual report is filed for services rendered to the plan or its participants, the amount of such compensation, the nature of such person's services to the plan or its participants, such person's relationship to each employer of the employees covered by the plan, any employer representative of each such employer, and any employee organization participating in the establishment or maintenance of the plan, and any other office, position, or employment such person holds with any party in interest;

(8) an explanation of the reason for any change in appointment of any consultant, broker, trustee, attorney, accountant, insurance carrier, actuary, administrator, investment manager, or custodian;

(9) a summary description of plan modifications or amendments described in paragraphs (1) and (2) of section 103(d); and

(10) any other information which is necessary to carry out the purposes of this Act and which the Secretary may require regarding—

(A) a termination of the plan,

(B) a merger or consolidation by the plan with another plan or a significant change in coverage by the plan, or

(C) a withdrawal from the plan by a contributing employer or employer representative.

FINANCIAL STATEMENT INCLUDED IN ANNUAL REPORT

SEC. 106. (a)(1) Except as provided in paragraph (3), the administrator of a plan shall engage in connection with the preparation of the plan's annual report, on behalf of all plan participants, an independent qualified public accountant. The accountant shall conduct such an examination of any financial statements of the plan, and of other books and records of the plan, as the accountant may consider necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual report by this section are presented fairly and in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards, except as provided in paragraphs (2) and (3), and shall involve such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant. The independent qualified public accountant shall also offer such accountant's opinion as to whether the separate schedules specified in subsection (b)(2) present fairly and in all material respects the information contained therein when considered in conjunction with the financial statements taken as a whole. The opinion by the independent qualified public accountant shall be made a part of the annual report. If by reason of section 104(b)(2) a plan is required only to file a simplified annual report, the Secretary may modify or waive the requirements of this section.

(2) In offering an opinion under this subsection, the accountant shall rely on the correctness of any actuarial matter certified to by an enrolled actuary.

(3) The opinion required by paragraph (1) shall not be expressed as to any statements required by subsection (c) to be prepared by a bank or similar institution or insurance car-

rier regulated, supervised, and subject to periodic examination by a State or Federal agency if such statements are certified by the bank, similar institution, or insurance carrier as accurate and are made a part of the annual report.

(4)(A) For purposes of this subsection, the term "independent qualified public accountant" means, when used in connection with a plan—

(i) a properly constituted audit agency of a State or a political subdivision of a State which has no direct relationship with the functions or activities examined thereby in connection with the plan or with the business conducted by any of the fiduciaries of the plan, including the officials of the plan or any trust constituting a part of the plan; and

(ii) any other qualified public accountant who is independent, as defined in regulations which shall be prescribed by the Secretary.

(B) For purposes of this paragraph, the term "qualified public accountant" means—

(i) a person who is a certified public accountant, certified by a regulatory authority of a State;

(ii) a person who is a licensed public accountant, licensed by a regulatory authority of a State; or

(iii) in the case of persons who practice as accountants for plans in States in which no certification or licensing procedure for accountants exists, such a person certified by the Secretary as a qualified public accountant in accordance with regulations prescribed by the Secretary.

(b) An annual report under this title covering any plan year shall include a financial statement containing the following information:

(1) A statement of assets and liabilities as of the end of the plan year, together with a statement of changes which occurred during the plan year in net assets available for plan benefits which shall include details of revenues and expenses and other changes aggregated by general source and application. In the notes to financial statements, disclosures concerning the following items shall be considered by the accountant:

(A) a description of the plan as of the end of the plan year, including any significant changes in the plan made during the plan year and the impact of such changes on benefits;

(B) the funding policy in effect during the plan year (including policy with respect to the funding of any unfunded supplemental actuarial value), and any changes in such policy during the year;

(C) a description of any significant changes in plan benefits made during the plan year;

(D) a description of material lease commitments, other commitments, and contingent liabilities undertaken during the plan year;

(E) a description of agreements and transactions entered into during the plan year with persons known to be parties in interest;

(F) a general description of any plan provision which was in effect during the plan year providing for allocation of assets upon termination of the plan;

(G) information concerning the plan's qualified status under section 401 of the Internal Revenue Code of 1954 during the plan year; and

(H) any other relevant information necessary to fully and fairly present the financial statements of such plan.

(2) The following information in separate schedules relating to the statement required under paragraph (1):

(A) a statement of the assets and liabilities of the plan as of the end of the plan year, aggregated by categories and valued at their current value, and the same data displayed in comparative form for the end of the preceding plan year;

(B) a statement of receipts and disbursements during the plan year, aggregated by general sources and applications;

(C) a schedule of—

(i) all assets held for investment purposes during the plan year, and

(ii) all assets so held as of the end of the plan year,

aggregated and identified by issuer, borrower, or lessor, or similar party to the transaction (including a notation as to whether such party is known to be a party in interest), maturity date, rate of interest, collateral, par or maturity value, cost, and current value;

(D) a schedule of each transaction entered into during the plan year (other than the payment of benefits pursuant to the terms of the plan) involving a person known to be a party in interest, the identity of such party in interest and the relationship of such party in interest to any other party in interest to the plan, a description of each asset to which the transaction relates; the purchase or selling price in the case of a sale or purchase, the rental in the case of a lease, or the interest rate and maturity date in the case of a loan; expenses incurred in connection with the transaction; the cost of the asset, the current value of the asset as of the end of the plan year, and the net gain (or loss) on each transaction;

(E) a schedule of all loans or fixed income obligations which were in default as of the end of the plan year or were classified during the plan year as uncollectible and the following information with respect to each loan on such schedule (including a notation as to whether the parties involved are known to be parties in interest):

(i) the original principal amount of the loan,

(ii) the amount of principal and interest received during the plan year,

(iii) the unpaid balance as of the end of the plan year,

(iv) the identity and address of the obligor as of the end of the plan year,

(v) a detailed description of the loan (including date of making and maturity, interest rate, the type and value of collateral, and other material terms), and

(vi) the amount of principal and interest overdue (if any) as of the end of the plan year and an explanation thereof; and

(F) a list of all leases which were in default during the plan year or were classified during the plan year as uncollectible; and the following information with respect to each lease on such schedule (including a notation as to whether the parties involved are known to be parties in interest):

(i) the type of property leased (and, in the case of fixed assets such as land, buildings, leasehold, and so forth, the location of the property),

(ii) the identity of the lessor or lessee from or to whom the plan is leasing,

(iii) the relationship of such lessors and lessees, if any, to the plan, each employer and any employer representative connected with the plan, any employee organization connected with the plan, and any other party in interest,

(iv) the terms of the lease regarding rent, taxes, insurance, repairs, expenses, and renewal options,

(v) the date the leased property was purchased and its cost,

(vi) the date the property was leased and its approximate value at such date,

(vii) any gross rental receipts during the plan year,

(viii) any expenses paid for the leased property during the plan year,

(ix) any net receipts from the lease,

(x) the amounts in arrears as of the end of the plan year, and

(xi) a statement as to what steps have been taken to collect amounts due or otherwise remedy any default.

(c)(1) If some or all of the assets of a plan or plans are held in a common or collective trust maintained by a bank or similar institution, a separate account maintained by an insurance carrier, or a separate trust maintained by a bank as trustee, the financial statement shall include the most recent annual statement of assets and liabilities of such common or collective trust, and in the case of a separate account or a separate trust, such other information as is required by the administrator in order to comply with this section.

(2) The Secretary may, by regulation, relieve any plan from filing a copy of a statement of assets and liabilities (or

other information) described in paragraph (1) if such statement or other information is filed with the Secretary by a bank or similar institution or insurance carrier which maintains the common or collective trust, separate account, or separate trust.

ACTUARIAL STATEMENT INCLUDED IN ANNUAL REPORT

SEC. 107. (a) With respect to a defined benefit plan (other than a plan having the same characteristics as an insurance contract plan described in section 301(b) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1081(b))), an annual report under this Act shall include a complete actuarial statement applicable to the plan year for which the report is filed.

(b) The administrator of a plan subject to this section shall engage, on behalf of all plan participants, an enrolled actuary who shall be responsible for the preparation of the materials comprising the actuarial statement required by this section and the performance of actuarial valuations required by section 109. In making a certification under this section, the enrolled actuary shall rely on the correctness of any accounting matter under section 106 with respect to which the independent qualified public accountant has expressed an opinion.

(c) The actuarial statement for a plan year shall include the following:

(1) The beginning and ending dates of the plan year, and the date of the actuarial valuation performed pursuant to section 109 applicable to the plan year.

(2) The total amount of the contributions made by the participants and the total amount of all other contributions, including employer contributions received by the plan, for each of the following:

(A) the plan year; and

(B) each of the preceding plan years for which such information was not previously reported.

(3) The total amount of the contributions of participants and the total amount of all other contributions, including employer contributions, for the plan year which are expected to be made but which are not reported under paragraph (2) as having been made.

(4) The total estimated amount of the covered compensation with respect to active participants for the plan year.

(5) The number, as of the date of the actuarial valuation performed pursuant to section 109 applicable to the plan year, of—

(A) active participants,

(B) terminated participants currently eligible for deferred vested pension benefits or the return of contributions made by such participants, and

(C) all other participants and beneficiaries included in the actuarial valuation performed pursuant to section 109.

(6) The following values as of the date of the actuarial valuation performed pursuant to section 109 applicable to the plan year:

(A) the current value of assets accumulated in the plan,

(B) the amount of accumulated mandatory contributions for active participants (including interest, if any), and

(C) the amount of accumulated voluntary contributions for active participants (including interest, if any).

The amounts in subparagraphs (B) and (C) may be combined if they are not available separately.

(7) The following information applicable to the plan year:

(A) a complete description of the basis on which the plan is funded,

(B) if an actuarial valuation for funding purposes was performed during the plan year—

(i) a description of the actuarial valuation method and actuarial assumptions, and

(ii) if computed, the annual actuarial value, the combined actuarial value (including a description of the method of calculating the portion of the combined actuarial value which is based on the unfunded supplemental actuarial value), and the unfunded supplemental actuarial value, and

(C) if such an actuarial valuation for funding purposes was not performed—

(i) the period for which the most recent actuarial valuation for funding purposes was performed, and

(ii) the frequency with which actuarial valuations for funding purposes are performed under the plan.

(8) The following actuarial values as of the date of the actuarial valuation performed pursuant to section 109 applicable to the plan year:

(A) the actuarial present value of all future plan benefits (including, if applicable, future automatic and ad hoc benefit increases which can be reasonably anticipated) for the individuals described in subparagraphs (A) and (B) of paragraph (5);

(B) the actuarial present value of accumulated plan benefits for—

(i) vested active participants, and

(ii) non-vested active participants;

(C) the actuarial present value of the total projected plan benefits (reflecting anticipated future increases in compensation and the cost of living, if applicable) which is inclusive of the amounts in subparagraphs (A) and (B);

(D) the actuarial present value of future covered compensation for active participants; and

(E) the actuarial value of the assets of the plan.

(9) A statement by the enrolled actuary that to the best of the actuary's knowledge the report under this subsection is complete and accurate and that in the actuary's opinion the assumptions and methods utilized for purposes of paragraph (8) meet the requirements of such paragraph.

(10) Such other information as may be necessary to fully and fairly disclose the actuarial position of the plan and any other information the enrolled actuary may present.

(d)(1) The enrolled actuary shall utilize on an explicit basis such assumptions and methods as are necessary for the contents of the matters reported under subsection (c)(8) to be reasonably related to the experience of the plan and to reasonable expectations and to represent the actuary's best estimate of anticipated experience under the plan.

(2) The actuarial statement under this subsection shall include a description of the actuarial assumptions and methods used to determine the actuarial values under subsection (c)(8) (including an identification of benefits not included in such actuarial values) and shall disclose the impact of significant changes in the actuarial assumptions and methods, plan provisions, and other pertinent factors on the actuarial position of the plan.

(3) Together with the actuarial statement with respect to the plan as a whole, a separate actuarial statement, including such information as the Secretary by regulation shall find to be consistent with this subsection, shall be filed for each subpart of the plan which, as determined by the Secretary, in accordance with regulations of the Secretary—

(A) covers at least 5 percent of the plan's active participants, and

(B) is operated as a separate plan for funding purposes, such that the assets of the subpart cannot be used for the payment of benefits to persons not covered by such subpart.

REPORT OF INSURANCE ORGANIZATION INCLUDED IN ANNUAL REPORT

SEC. 108. (a) If some or all of the benefits under a public employee pension benefit plan are purchased from and guaranteed by an insurance company, insurance service, or other similar organization, the annual report for a plan year shall include a statement from such insurance company, service, or other similar organization covering the plan year and enumerating—

(1) the premium rate or subscription charge and the total premium or subscription charges paid to each such carrier, insurance service, or other similar organization;

(2) the total amount of premiums received, the approximate number of persons covered by each class of benefits, and the total claims paid by such company, service, or other organization;

(3) dividends or retroactive rate adjustments, commissions, and administrative service or other fees or other specific acquisition costs paid by such company, service, or other organization;

(4) any amounts held to provide benefits after retirement; and

(5) the remainder of such premiums, and the names and addresses of the brokers, agents, or other persons to whom commissions or fees were paid, the amount paid to each, and for what purpose.

(b) If any such company, service, or other organization does not maintain separate experience records covering the specific groups it serves, the report shall include, in lieu of the information required by paragraphs (2) through (5) of subsection (a), the following:

(1) a statement as to the basis of its premium rate or subscription charge, the total amount of premiums or subscription charges received from the plan, and a copy of the financial report of the company, service, or other organization; and

(2) if such company, service, or organization incurs specific costs in connection with the acquisition or retention of any particular plan or plans, a detailed statement of such costs.

PERIODIC ACTUARIAL VALUATIONS

SEC. 109. (a) The enrolled actuary of a public employee pension benefit plan shall make an actuarial valuation of the plan at least once every three plan years.

(b) In accordance with regulations which shall be prescribed by the Secretary, actuarial valuations under this section shall be made more frequently if the enrolled actuary determines—

(1) that amendments to the plan are made which significantly affect the actuarial position of the plan, or

(2) that a more frequent valuation is necessary to support the actuary's opinion under section 107(c)(9).

INFORMATION TO BE PROVIDED TO PARTICIPANTS, BENEFICIARIES, AND OTHER PERSONS

SEC. 110. (a)(1) The administrator of a public employee pension benefit plan shall furnish to each individual who is a participant, or is a beneficiary receiving benefits under the plan, as required by this section, a copy of the summary plan description, including all modifications and changes referred to in section 103(d) a summary description of which has been furnished to other participants and beneficiaries—

(A) in the case of a participant, within ninety days after the individual becomes a participant, or, in the case of a beneficiary, within ninety days after the individual first receives benefits, or

(B) if later, within one hundred and twenty days after the plan becomes subject to this title.

(2) If there is a modification or change described in section 103(d), the administrator shall furnish a summary description of such modification or change to each participant, and to each beneficiary who is receiving benefits under the

plan, whose future benefits may reasonably be expected to be affected thereby. The administrator shall furnish such summary description not later than two hundred and ten days after the end of the plan year in which the modification or change is adopted, or within such time as the Secretary may prescribe by regulation.

(3) Any updated summary plan description required under section 103(d) shall be provided to each participant and each beneficiary receiving benefits under the plan whose future benefits may reasonably be expected to be affected by any plan amendment made within the period described in section 103(d).

(b) In the case of any public employee pension benefit plan, upon written request of any—

(1) participant of the plan,

(2) beneficiary of the plan,

(3) employee organization which represents employees covered in whole or in part by the plan, or

(4) resident of any State, if—

(A) such State, any agency or instrumentality of such State, any political subdivision of such State, or any agency or instrumentality of a political subdivision of such State is an employer with respect to such plan or is one of a group or association which is an employer representative (as defined in section 3(16)(A)) with respect to such plan, or

(B) any person is an employer representative (as defined in section 3(16)(B)) with respect to such plan acting in the interest of any of the persons referred to in subparagraph (A),

the administrator shall furnish a copy of summary plan descriptions, annual reports, bargaining agreements, trust agreements, contracts, or other instruments under which the plan is established or operated. The administrator may make a reasonable charge to cover the cost of furnishing such copies. The Secretary may by regulation prescribe the maximum amount which will constitute a reasonable charge.

(c) The administrator shall make copies of the documents described in subsection (b) available for examination by any person described in subsection (b) in the principal office of the administrator and in such other places as may be necessary to make such documents available to all participants (including such places as the Secretary may prescribe by regulation).

REPORTING OF PARTICIPANT'S BENEFIT RIGHTS

SEC. 111. (a) The administrator shall furnish to any plan participant or beneficiary who so requests in writing, a statement indicating, on the basis of the latest available information—

(1) the total accumulated plan benefits,

(2) the extent to which benefits are or will become vested pension benefits,

(3) if applicable, the earliest date on which such accumulated plan benefits are expected to become vested pension benefits, and

(4) the total accumulated contributions made by the participant, including interest, if any, pursuant to the terms of the plan.

(b) In no case shall a participant or beneficiary be entitled under this section to receive more than one report described in subsection (a) during any one twelve-month period. If an administrator furnishes an annual statement which contains the information described in subsection (a), the furnishing of such annual statement shall satisfy the requirements of subsection (a).

(c) The administrator shall provide to each participant in the plan—

(1) who in the year preceding the plan year for which the annual report is filed, separated from service covered by the plan,

(2) who did not return to service covered by the plan by the end of the plan year for which the annual report is filed,

(3) who is entitled to a vested pension benefit under the plan (or would be so entitled within two years) or is entitled to the return of employee contributions, and

(4) with respect to whom benefits were not paid under the plan during such plan years,

a statement setting forth the nature, amount, and form of any benefits to which such participant is entitled, including but not limited to the contributions made by such participant, if any, and the interest on such contributions, if any. Such statement shall be provided within the time prescribed for the filing of such annual report.

(d) The administrator shall furnish to any participant or beneficiary who requests—

(1) the withdrawal of contributions made by a participant,

(2) the payment of any benefit from the plan, or

(3) in accordance with the terms of the plan, an election as to the form of benefits to be made available under the provisions of the plan,

a written explanation of the effect of such withdrawal, payment, or election on the remaining plan benefits of the participant or beneficiary. Such explanation shall include a description of the various alternative forms of benefit payments, if any, which the participant may elect. No such election shall be final until thirty days shall have elapsed from the date on which such explanation is furnished to the participant or beneficiary or, if earlier, the date any payment is made in accordance with such election. The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this subsection.

FILING WITH THE SECRETARY

SEC. 112. (a)(1) The administrator of any public employee pension benefit plan subject to this Act shall file with the Secretary—

(A) the annual report for a plan year within two hundred and ten days after the close of such year (or within such time as may be required by regulations promulgated by the Secretary); and

(B) a copy of the summary plan description at the time the annual report is filed, or such other time as established by the Secretary in regulations.

The administrator shall also furnish to the Secretary, upon request, any documents relating to the plan, including but not limited to the bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated.

(2) Except as provided in subsection (b) and paragraph (3) of this subsection, the contents of the descriptions, annual reports, statements, and other documents filed with the Sec-

retary pursuant to this title shall be public information and the Secretary shall make any such information and data available for inspection in the public document room of the Secretary. The Secretary and the Advisory Council on Governmental Plans (established under section 307) may use the information and data for statistical and research purposes, and compile and publish such studies, analyses, reports, and surveys based thereon as they may consider appropriate.

(3)(A) Any information consisting of the contents of the descriptions, annual reports, statements, and other documents filed with the Secretary pursuant to this title may be provided in computer-compatible form to the public only after a statement has been filed with the Secretary by the person receiving the information which provides that the information will not be—

(i) used by that person in the distribution of solicitations, by mail, telephone, or otherwise, for any commercial purpose, or

(ii) given by the person receiving the information to any other person who the person receiving the information has reasonable grounds to believe will use such information in the distribution of solicitations, by mail, telephone, or otherwise, for any commercial purpose.

(B) Any person who files a statement described in subparagraph (A) and who takes any action described in clause

(i) or (ii) of subparagraph (A) shall be subject to a civil penalty of an amount not to exceed $5,000. Any such penalty shall be assessed by the Secretary.

(b) Information required to be furnished pursuant to subsections (a) and (c) of section 111 with respect to a participant may be disclosed by the Secretary only to the extent that information with respect to that participant's benefits under title II of the Social Security Act (42 U.S.C. 401 et seq.) may be disclosed under such Act.

(c) The Secretary may reject any filing under this section if the Secretary determines that—

(1) such filing is incomplete, or

(2) there is any material qualification by an accountant or actuary contained in an opinion or statement submitted pursuant to section 106 or 107.

(d)(1) Paragraph (2) shall apply in any case in which—

(A) the Secretary rejects a filing of a report under subsection (c),

(B) a revised filing satisfactory to the Secretary is not submitted within forty-five days after the Secretary makes a determination under subsection (c) to reject the filing, and

(C) the Secretary considers it in the best interest of the participants.

(2) In any case to which this paragraph applies, the Secretary may take, in addition to any other action authorized by this Act, any one or more of the following actions:

(A) retain an independent qualified public accountant (as defined in section 106(a)(4)) on behalf of the participants to perform an audit,

(B) retain an enrolled actuary, on behalf of the plan participants, to prepare an actuarial report, or

(C) bring a civil action for such legal or equitable relief as may be appropriate to enforce the provisions of this title.

The administrator shall permit such accountant or actuary to make such inspection of the books and records of the plan as the accountant or actuary considers necessary to conduct any such audit or prepare any such actuarial report. The plan shall be liable to the Secretary for the expenses for any such audit or actuarial report, and the Secretary may bring an action against the plan in any court of competent jurisdiction to recover such expenses.

RETENTION OF RECORDS

SEC. 113. Every person who is subject to a requirement to file any description or report or to certify any information therein under this Act, or who would be subject to such a requirement but for an exemption under section 115 or simplified reporting requirement under section 104(b)(2), shall maintain records on the matters of which disclosure is thus required or would have been required but for such an exemption or simplified reporting requirement. Such records shall provide in sufficient detail the necessary basic information and data from which the documents which are required or which would have been required may be reconstructed, verified, explained, or clarified, and checked for accuracy and completeness, including but not limited to vouchers, worksheets, receipts, computer tapes and discs, and applicable resolutions. Such records shall be kept available for examination for a period of not less than six years after the filing date of the documents based on the information which they contain, or not less than six years after the date on which such documents would have been filed but for an exemption under section 115 or simplified reporting requirement under section 104(b)(2).

CLAIMS PROCEDURE

SEC. 114. In accordance with such regulations as the Secretary may prescribe, every plan shall provide to any participant or beneficiary whose claim for benefits under the plan has been denied in whole or in part—

(1) adequate notice setting forth the specific reasons for such denial and written in a manner calculated to be understood by the participant or beneficiary, and

(2) a reasonable opportunity for a full and fair review of the decision denying the claim.

ALTERNATIVE METHODS OF COMPLIANCE; OTHER EXEMPTIONS

SEC. 115. (a) The Secretary may take the following actions with respect to any public employee pension benefit plan to which this Act applies:

(1) The Secretary, on the Secretary's own motion or after having received the petition of an administrator, may prescribe an alternative method for satisfying any requirement of this title with respect to any plan, or class of plans, subject to such requirement if the Secretary determines that—

(A) the use of such alternative method is consistent with the purposes of this Act and it provides adequate disclosure to the participants and beneficiaries in the plan and to other persons entitled to disclosure under this title, and adequate reporting to the Secretary, and

(B) the application of such alternative method would—

(i) substantially decrease the costs to the plan, or

(ii) avoid unreasonable administrative burdens with respect to the operation of the plan.

(2) The Secretary may prescribe an alternative method under subsection (a) by regulation or otherwise. If an alternative method is prescribed other than by regulation, the Secretary shall provide notice and an opportunity for interested persons to present their views, and shall publish in the Federal Register the provisions of such alternative method.

(3) The Secretary may by regulation exempt any plan or any class of plans conditionally or unconditionally from any requirement of this title if the Secretary determines, after giving full consideration to the use of alternative methods, that such exemption is—

(A) appropriate and necessary in the public interest, and

(B) consistent with the purposes of this Act.

(b) Before issuing any exemption or prescribing any alternative method under this section, the Secretary shall take into account any recommendations made by the Advisory Council on Governmental Plans (established under section 307).

TITLE II—REQUIREMENTS RELATING TO FIDUCIARY FUNCTIONS

FIDUCIARY FUNCTIONS; SPECIAL ASSET RULES

SEC. 201. (a) For purposes of this title, the term "function", when used in connection with a fiduciary, means any duty, obligation, power, authority, responsibility, right, privilege, activity, or program.

(b) For purposes of this title:

(1) In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.), the assets of such plan shall be deemed to include such security but shall not, solely by reason of such investment, be deemed to include any assets of such investment company.

(2) In the case of a plan which is funded in whole or in part by a contract, or policy of insurance, issued by an insurer, the assets of the plan shall include such contract or policy but shall not, solely by reason of the issuance of such contract or policy, include the assets of the insurer issuing the contract or policy except to the extent that such assets are maintained by the insurer in one or more separate accounts and do not constitute surplus in any such account. For purposes of this paragraph, the term "insurer" means an insurance

company, insurance service, or insurance organization, qualified to conduct business in more than one State.

ESTABLISHMENT OF PLAN

SEC. 202. (a)(1) Every plan shall be established and maintained pursuant to written instruments. Such instruments shall provide for the designation of one or more named fiduciaries, in a plan instrument or pursuant to a procedure specified in a plan instrument, who shall have authority to control and manage the operation and administration of the plan.

(2) For purposes of this title, the term "instrument" shall include a law of a State or of a political subdivision of a State.

(b) Every plan shall—

(1) state whether a funding policy or goal has been established for the plan, and shall describe the funding policy or goal, the method for carrying out such policy or goal, if any, and the source of funds,

(2) describe the procedure under the plan for any allocation of functions relating to the operation and administration of the plan (including any allocation or designation under subsection (c)(4)),

(3) provide a procedure for amending such plan, and for identifying the persons who have authority to

amend the plan, except to the extent that the procedure for amending such plan is by legislation,

(4) specify the provisions relating to benefits (including but not limited to eligibility, benefit levels, and the form and method of payment of benefits), and

(5) provide a procedure for determining whether contributions from all employers or employer representatives are made in a timely manner and for resolving any disputes as to the timing or amount of such contributions.

(c) Any plan may provide that—

(1) any person or group of persons may serve in more than one fiduciary capacity with respect to the plan (including service both as trustee and as named fiduciary);

(2) a named fiduciary may employ one or more persons to render advice with respect to any function such named fiduciary has under the plan;

(3) a person who is a named fiduciary with investment functions with respect to the plan may appoint one or more investment managers as fiduciaries to manage (including the power to acquire and dispose of) any assets of a plan;

(4) named fiduciaries may allocate functions (other than trustee functions) among themselves and designate

others as fiduciaries to carry out specific fiduciary functions (other than trustee functions);

(5) trustee functions may be allocated among trustees named or appointed under section 203; and

(6) the trustee or trustees of the plan named or appointed under section 203 are subject to the direction of a named fiduciary.

(d) For purposes of this title, the term "trustee function" means any function provided in the plan's trust instrument (if any) relating to the management or control of the assets of the plan, other than the appointment, as provided in the trust instrument, by a named fiduciary of an investment manager in accordance with subsection (c)(3).

ESTABLISHMENT OF TRUST

SEC. 203. (a) Except as provided in subsection (b), all assets of a plan shall be held in trust by one or more trustees. Any such trustee shall be a named fiduciary or appointed by a named fiduciary. Upon acceptance of being named or appointed, the trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that—

(1) the plan expressly provides pursuant to section 202(c)(6) that the trustee or trustees are subject to the direction of a named fiduciary, in which case the trustee or trustees shall be subject to proper directions of

such named fiduciary which are made in accordance with the terms of the plan and which are consistent with the requirements of this title, or

(2) authority to manage, acquire, or dispose of assets of the plan is delegated by a named fiduciary to 1 or more investment managers pursuant to section 202(c)(3).

(b) The requirements of subsection (a) of this section shall not apply—

(1) to any assets of a plan which consist of insurance contracts or policies issued by an insurance company qualified to do business in a State; or

(2) to any assets of such an insurance company or any assets of a plan which are held by such an insurance company.

(c)(1) Except as provided in paragraph (2), the assets of a plan shall never inure to the benefit of any employer, employer representative, or other person employing participants in the plan and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

(2) In the case of a contribution which is made by a mistake of fact or law, paragraph (1) shall not prohibit the return of such contribution within 1 year after the adminis-

trator determines that the contribution was made by such a mistake.

GENERAL REQUIREMENTS RELATING TO FIDUCIARY FUNCTIONS

SEC. 204. (a) Subject to section 203(c), a fiduciary shall carry out such fiduciary's functions with respect to a plan solely in the interest of the participants and beneficiaries and—

(1) for the exclusive purpose of—

(A) providing benefits to participants and their beneficiaries; and

(B) defraying reasonable expenses of administering the plan;

(2) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person 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;

(3) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(4) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this Act.

(b) Except as authorized by the Secretary by regulation, no fiduciary may maintain the indicia of ownership of any assets of a plan outside the jurisdiction of the district courts of the United States.

(c) In the case of a plan which provides for individual accounts and permits a participant or beneficiary to exercise control over assets in the account of the participant or beneficiary, if the participant or beneficiary exercises control over the assets in the account (as may be determined under regulations of the Secretary)—

(1) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and

(2) no person who is otherwise a fiduciary shall be liable under this title for any loss, or by reason of any failure to meet requirements relating to fiduciary functions, which results from such participant's or beneficiary's exercise of control.

EXTENT OF COFIDUCIARY FUNCTIONS AND LIABILITY RELATING THERETO

SEC. 205. (a) In addition to any liability which a particular fiduciary with respect to a public employee pension benefit plan may have under any other provision of this title, such a fiduciary shall be liable for any failure to meet any requirement under this Act relating to fiduciary functions by any other fiduciary with respect to the same plan in the following circumstances:

(1) if such particular fiduciary participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a failure to meet any such requirement;

(2) if, by such particular fiduciary's failure to comply with section 204(a) in the administration of the specific functions which give rise to such fiduciary's status as a fiduciary, such fiduciary has enabled such other fiduciary to fail to meet any such requirement; or

(3) if such particular fiduciary has knowledge of a failure to meet any such requirement by such other fiduciary, unless such particular fiduciary makes reasonable efforts under the circumstances to remedy the failure.

For purposes of paragraph (3), the term "knowledge" means knowledge actually learned or communicated, or knowledge which, in the ordinary course of business, should have been learned or communicated.

(b)(1) Except as otherwise provided in this subsection, if the assets of a plan are held by two or more trustees—

(A) each shall use reasonable care to prevent a cotrustee from failing to meet any requirement under this Act relating to fiduciary functions, and

(B) they shall jointly manage and control the assets of the plan.

(2) Nothing in paragraph (1)(B) shall preclude any allocation of trustee functions (as defined in section 202(d)) among trustees as authorized by section 202(c)(5). In the case of any such allocation, a trustee to whom certain functions have not been allocated shall not be liable by reason of paragraph (1) either individually or as a trustee for any loss resulting to the plan arising from the acts or omissions on the part of another trustee to whom such functions have been allocated.

(3)(A) If an investment manager or managers have been appointed under section 202(c)(3), then, notwithstanding paragraphs (2) and (3) of subsection (a) and the preceding provisions of this subsection, no trustee shall be liable under this title for the acts or omissions of such investment manager or managers, or be under an obligation to invest or otherwise manage any asset of the plan which is subject to the management of such investment manager.

(B) Nothing in this paragraph shall relieve any trustee of any liability under this title for any act or omission of such trustee.

(4) In the case of a plan the assets of which are held in more than one trust, a trustee of the plan may be liable under paragraph (1) with respect to an act or omission of any other

trustee affecting one of such trusts only if both of such trustees are trustees of such trust.

(5) No trustee shall be liable under this subsection for following directions referred to in section 203(a)(1).

(6) Except as provided in paragraph (3), nothing in this subsection shall limit any liability that a fiduciary may have under subsection (a) or any other provision of this title.

(c) If a plan expressly provides for an allocation or designation authorized under section 202(c) (3) or (4), and pursuant to such allocation or designation any fiduciary function of a named fiduciary is allocated to any person, or a person is designated to carry out any such function, then such named fiduciary shall not be liable under this title for an act or omission of such person in carrying out such function except to the extent that—

(1) the named fiduciary violated section 204(a)—

(A) with respect to such allocation or designation,

(B) with respect to the establishment or implementation of the allocation or designation, or

(C) in continuing the allocation or designation; or

(2) the named fiduciary would otherwise be liable in accordance with subsection (a).

PROHIBITED TRANSACTIONS

SEC. 206. (a) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction if such fiduciary knows or should know that such transaction constitutes a direct or indirect—

(1) sale or exchange, or leasing, of any property from the plan to a party in interest for less than adequate consideration, or from a party in interest to a plan for more than adequate consideration;

(2) lending of money or other extension of credit from the plan to a party in interest without the receipt of adequate security and a rate of interest which is consistent with the requirements relating to fiduciary functions under section 204, or from a party in interest to a plan with the provision of excessive security or a rate of interest which is inconsistent with the requirements relating to fiduciary functions under section 204;

(3) furnishing of goods, services, or facilities from the plan to a party in interest for less than adequate consideration, or from a party in interest to a plan for more than adequate consideration;

(4) transfer to, or use by or for the benefit of, a party in interest of any assets of the plan for less than adequate consideration; or

(5) acquisition, on behalf of the plan, of any employer security, employer real property, or employer loan, in violation of section 207(a).

(b) A fiduciary with respect to a plan shall not—

(1) deal with the assets of the plan in the fiduciary's own interest or for the fiduciary's own account,

(2) in the fiduciary's individual or in any other capacity, act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for such fiduciary's own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

FIVE PER CENTUM LIMITATION WITH RESPECT TO ACQUISITION OF EMPLOYER SECURITIES, OTHER EMPLOYER OBLIGATIONS, AND EMPLOYER REAL PROPERTY

SEC. 207. (a)(1) Except as otherwise provided in this section—

(A) a plan may not acquire—

(i) any employer security which is not a qualifying employer security,

(ii) any employer real property which is not qualifying employer real property, or

(iii) any employer loan (including any other extension of credit) which is not a qualifying employer loan, and

(B) a plan may not acquire any qualifying employer security, qualifying employer real property, or qualifying employer loan, if immediately after such acquisition the aggregate fair market value of employer securities, employer real property, and employer loans held by the plan exceeds 5 per centum of the fair market value of the assets of the plan.

(2) Notwithstanding paragraph (1)(B), a plan may acquire qualifying employer securities, qualifying employer real property, and qualifying employer loans if such acquisitions are made pursuant to a binding contractual obligation made prior to the date of the enactment of this Act.

(b) For purposes of this section—

(1) The term "employer security" means a security issued by an employer of employees covered by the plan, an employer representative of such an employer, or any other person required to make employer contributions under the plan, or by an affiliate of such employer or employer representative.

(2) The term "qualifying employer security" means an employer security which is stock or a marketable obligation (as defined in subsection (c)).

(3) The term "employer real property" means real property (and related personal property) which is leased to an employer of employees covered by the plan, an employer representative of such an employer, or any other person required to make employer contributions under the plan, or to an affiliate of such employer or employer representative. For purposes of determining the time at which a plan acquires employer real property for purposes of this section, such property shall be deemed to be acquired by the plan on the date on which the plan acquires the property or on the date on which the lease to such an employer (or affiliate thereof), such an employer representative (or affiliate thereof), or such other person is entered into, whichever is later.

(4) The term "qualifying employer real property" means one or more parcels of employer real property—

(A) if, in the case of employer real property consisting of three or more parcels, a substantial number of the parcels are dispersed geographically;

(B) if each parcel of real property and the improvements thereon are suitable (or adaptable without excessive cost) for more than one use; and

(C) if the acquisition of such property complies with the provisions of this title (other than section 204(a)(2) to the extent it requires diversification, section 204(a)(3), section 206, and subsection (a) of this section).

(5) The term "employer loan" means a loan or other extension of credit, not otherwise described in paragraph (1), issued or otherwise entered into by an employer of employees covered by the plan, an employer representative of such an employer, or any other person required to make employer contributions under the plan, or by an affiliate of such employer or employer representative. A failure of such an employer, employer representative, or other person to make contributions when due, unless evidenced by a promissory note, shall not be considered a loan or other extension of credit.

(6) The term "qualifying employer loan" means an employer loan which bears a rate of interest which is consistent with the requirements relating to fiduciary functions under section 204 and which is fully secured

by marketable securities, or such other employer loan as defined under regulations issued by the Secretary.

(7)(A) The term "affiliate" means—

(i) when used in connection with any person referred to in subparagraph (B), any other person referred to in subparagraph (B); and

(ii) when used in connection with an employer representative (as defined in section 3(16)(B)) acting in the interest of any person referred to in subparagraph (B), such person or any other person referred to in subparagraph (B).

(B) The persons referred to in this subparagraph are the following: a State; any agency or instrumentality of such State; any political subdivision of such State; any agency or instrumentality of any political subdivision of such State; and any group or association consisting in whole or in part of any combination of the foregoing.

(c) For purposes of subsection (b)(2), the terms "marketable obligation" and "obligation" mean a bond, debenture, note, certificate, or other evidence of indebtedness if—

(1) the obligation is acquired—

(A) on the market, either (i) at the price of the obligation prevailing on a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f), or (ii) if the obligation is not traded on such a national securities exchange, at a price not less favorable to the plan than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer;

(B) from an underwriter, at a price (i) not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular, and (ii) at which a substantial portion of the same issue is acquired by persons independent of the issuer; or

(C) directly from the issuer, at a price not less favorable to the plan than the price paid currently for a substantial portion of the same issue by persons independent of the issuer; and

(2) immediately following acquisition of such obligation—

(A) not more than 25 per centum of the aggregate amount of obligations issued in such issue and outstanding at the time of acquisition is held by the plan, and

(B) at least 50 per centum of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer.

EXEMPTIONS FROM PROHIBITED TRANSACTIONS

SEC. 208. (a) The Secretary shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, the Secretary may grant a conditional or unconditional exemption of any fiduciary or transaction, or class of fiduciaries or transactions, from all or part of the restrictions imposed by section 206. An exemption granted under this subsection shall not relieve a fiduciary from any other applicable provisions of this Act. The Secretary may not grant an exemption under this subsection unless the Secretary finds that such exemption is—

(1) administratively feasible,

(2) in the interests of the plan and of its participants and beneficiaries, and

(3) protective of the rights of participants and beneficiaries of such plan.

The Secretary may not grant an exemption under this subsection from section 206 unless the Secretary affords an opportunity for a hearing and makes a determination on the record with respect to the findings required by paragraphs (1), (2), and (3).

(b) The prohibitions provided in section 206 shall not apply to any of the following transactions:

(1) Any loans made by the plan to parties in interest who are participants or beneficiaries of the plan if such loans—

(A) are available to all such participants and beneficiaries on a reasonably equivalent basis,

(B) are not made available to highly compensated employees, officers, or fiduciaries in an amount greater than the amount made available to other employees,

(C) are made in accordance with specific provisions regarding such loans set forth in the plan,

(D) bear a rate of interest which is consistent with the requirements relating to fiduciary functions under section 204, and

(E) are adequately secured.

(2) Contracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor.

(3) The investment of all or part of a plan's assets, in deposits which bear an interest rate which is consistent with the requirements relating to fiduciary

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functions under section 204, in a bank or similar institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if the investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or other institution or an affiliate thereof) who is expressly empowered by the plan to authorize such investment.

(4) The providing of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan, and if—

(A) such bank or other institution has adopted adequate internal safeguards which assure that the providing of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and

(B) the extent to which such ancillary service is provided is subject to specific guidelines issued by such institution (as determined by the Secretary after consultation with Federal and State supervisory authority), and adherence to such guidelines would reasonably preclude such bank or other institution from providing such ancillary service (i) in an excessive or unreasonable manner, and (ii) in a manner that would be inconsistent with the best interests of participants and beneficiaries of plans.

Such ancillary services shall not be provided at more than reasonable compensation.

(5) Any transaction between a plan and (A) a common or collective trust fund or pooled investment fund maintained by a party in interest which is a bank or trust company supervised by a State or Federal agency or (B) a pooled investment fund of an insurance company qualified to do business in a State, if—

(i) the transaction is a sale or purchase of an interest in the fund,

(ii) the bank, trust company, or insurance company receives not more than reasonable compensation, and

(iii) such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who has authority to manage and control the assets of the plan.

(c) Nothing in section 206(b) shall be construed to prohibit—

(1) a fiduciary or party in interest from receiving any benefit to which the fiduciary or party in interest may be entitled as a participant or beneficiary in the plan, or paying any benefit to any participant or beneficiary, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as generally applied to all participants and beneficiaries;

(2) a fiduciary or party in interest from receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of the functions of the fiduciary or party in interest with respect to the plan, except that no person so serving who already receives full-time pay from an employer whose employees are participants in the plan, an employer representative of such an employer, or an employee organization whose members are participants in such plan, shall receive compensation from such plan, except for reimbursement of expenses properly and actually incurred; or

(3) a fiduciary from serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest.

(d) Section 206 shall not apply to the acquisition or sale by a plan of qualifying employer securities (as defined in section 207(b)(2)); the acquisition, sale, or lease by a plan of qualifying employer real property (as defined in section 207(b)(4)), or the acquisition of a qualifying employer loan (as defined in section 207(b)(6))—

(1) if such acquisition, sale, or lease is for adequate consideration (or in the case of a marketable obligation, at a price not less favorable to the plan than the price determined under section 207(c)(1)),

(2) if no commission is charged with respect thereto, and

(3) if the acquisition or lease is not prohibited by section 207(a).

LIABILITY FOR FAILURE TO MEET REQUIREMENTS RELATING TO FIDUCIARY FUNCTIONS

SEC. 209. (a) Any person who is a fiduciary with respect to a plan who fails to meet any of the requirements imposed upon fiduciaries by this Act relating to fiduciary functions shall be personally liable to make good to such plan any losses to the plan resulting from each such failure, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary or any other person, and shall be subject to such equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 211.

(b) No person shall be liable with respect to a failure to meet a requirement under this Act relating to fiduciary functions if such failure occurred before such person became a fiduciary or after such person ceased to be a fiduciary.

EXCULPATORY PROVISIONS; INSURANCE

SEC. 210. (a) Except as otherwise provided in this title, any provision in an agreement or instrument which purports to relieve a fiduciary from a requirement under this Act relating to fiduciary functions or liability under this title for a failure to meet any such requirement shall be void as against public policy.

(b) Nothing in this section shall preclude—

(1) a plan from purchasing insurance for its fiduciaries or for itself to cover liability or losses occurring by reason of the act or omission of a fiduciary, but only if such insurance permits recourse by the insurer against the fiduciary in the case of a failure by such fiduciary to meet a requirement under this title relating to fiduciary functions;

(2) a fiduciary from purchasing insurance to cover liability under this title from and for such fiduciary's own account; or

(3) an employer, employer representative, or employee organization from purchasing insurance to cover

potential liability of one or more persons who serve as fiduciaries with respect to a plan.

PROHIBITION AGAINST CERTAIN PERSONS HOLDING CERTAIN POSITIONS

SEC. 211. (a)(1) No person who has been convicted of, or has been imprisoned as a result of such person's conviction for, robbery, bribery, extortion, embezzlement, fraud, grand larceny, burglary, arson, a felony violation of Federal or State law involving substances defined in section 102(6) of the Comprehensive Drug Abuse Prevention and Control Act of 1970 (21 U.S.C. 802(6)), murder, rape, kidnaping, perjury, assault with intent to kill, any crime described in section 9(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a–9(a)(1)), a violation of any provision of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1001 et seq.), a violation of section 302 of the Labor-Management Relations Act of 1947 (29 U.S.C. 186), a violation of chapter 63 of title 18, United States Code, a violation of section 874, 1027, 1503, 1505, 1506, 1510, 1951, or 1954 of title 18, United States Code, a violation of the Labor-Management Reporting and Disclosure Act of 1959 (29 U.S.C. 401 et seq.), or conspiracy to commit any such crimes or attempt to commit any such crimes, or a crime of which any of the foregoing crimes is an element, shall serve or be permitted to serve as an administrator, officer, trustee, custodian, counsel, agent, or consultant or in any other capacity as a fiduciary, with respect to any public employee pension benefit plan during or for five years after such conviction or after the end of such imprisonment, whichever is the later, unless prior to the end of such five year period, in the case of a person so convicted or imprisoned, (A) such person's citizenship rights, having been revoked as a result of such conviction, have been fully restored, or (B) the Board of Parole of the United States Department of Justice determines that such person's service as a fiduciary would not be contrary to the purposes of this Act.

(2) Before making any such determination the Board shall hold an administrative hearing and shall give notice of such proceeding by certified mail to the State, county, and Federal prosecuting officials in the jurisdiction or jurisdictions in which such person was convicted. The Board's determination in any such proceeding shall be final. No person shall knowingly permit any other person to serve as an administrator, officer, trustee, custodian, counsel, or consultant or in any other capacity as a fiduciary in violation of this subsection.

(3) Notwithstanding the preceding provisions of this subsection, no corporation or partnership will be precluded from serving as a fiduciary with respect to any plan without a notice, hearing, and determination by such Board of Parole

that such service would be inconsistent with the intention of this section.

(b) For the purposes of this section:

(1) A person shall be deemed to have been "convicted" and under the disability of "conviction" from the date of the judgment of the trial court or the date of the final sustaining of such judgment on appeal, whichever is later.

(2) The term "consultant" means any person who, for compensation, advises or represents a plan or who provides other assistance to such plan, concerning the establishment or operation of such plan.

(3) A period of parole shall not be considered as part of a period of imprisonment.

(c) Notwithstanding any other provision of this section, no elected official shall be precluded from serving as a fiduciary because of a conviction described in subsection (a) if the fiduciary serves solely by reason of the requirements of the fiduciary's elected office.

BONDING

SEC. 212. (a) Every fiduciary with respect to a plan and every person who handles funds or other property of such a plan (hereinafter in this section referred to as "plan official") shall be bonded as provided in this section; except that—

(1) if such plan is one under which the only assets from which benefits are paid are the general assets of an employee organization, of an employer, or of an employer representative, the administrator, officers, and employees of such plan shall be exempt from the bonding requirements of this section, and

(2) no bond shall be required of a fiduciary (or of any director, officer, or employee of such fiduciary) if such fiduciary—

(A) is a corporation organized and doing business under the laws of the United States or of any State;

(B) is authorized under such laws to exercise trust powers or to conduct an insurance business;

(C) is subject to supervision or examination by Federal or State authority; and

(D) has at all times a combined capital and surplus in excess of such a minimum amount as may be established by regulations issued by the Secretary, which amount shall be at least $1,000,000.

Paragraph (2) shall apply to a bank or other financial institution which is authorized to exercise trust powers and the deposits of which are not insured by the Federal Deposit Insurance Corporation only if such bank or institution meets bonding or similar requirements under State law which the Secretary determines are at least equivalent to those imposed on banks by Federal law.

(b)(1) The amount of such bond shall be fixed at the beginning of each fiscal year of the plan. Such amount shall be not less than 10 percent of the amount of funds handled. In no case shall such bond be less than $1,000 nor more than $500,000, except that the Secretary, after due notice and opportunity for hearing to all interested parties, and after consideration of the record, may prescribe an amount in excess of $500,000, which in no event may exceed 10 percent of the funds handled.

(2) For purposes of fixing the amount of such bond, the amount of funds handled shall be determined by the funds handled by the person, group, or class to be covered by such bond and by their predecessor or predecessors, if any, during the preceding reporting year, or if the plan has no preceding reporting year, the amount of funds to be handled during the current reporting year by such person, group, or class, estimated as provided in regulations of the Secretary.

(3) Such bond shall provide protection to the plan against loss by reason of acts of fraud or dishonesty on the part of the plan official, directly or through connivance with others. Any bond shall have as surety thereon a corporate surety company which is an acceptable surety on Federal

bonds under authority granted by the Secretary of the Treasury pursuant to sections 6 through 13 of title 6, United States Code. Any bond shall be in a form or of a type approved by the Secretary, including individual bonds or schedule or blanket forms of bonds which cover a group or class.

(c) It shall be unlawful for any plan official to whom subsection (a) applies, to receive, handle, disburse, or otherwise exercise custody or control of any of the funds or other property of any plan, without being bonded as required by subsection (a) and it shall be unlawful for any plan official of such plan, or any other person having authority to direct the performance of such functions, to permit such functions, or any of them, to be performed by any plan official, with respect to whom the requirements of subsection (a) have not been met.

(d) It shall be unlawful for any person to procure any bond required by subsection (a) from any surety or other company or through any agent or broker in whose business operations such plan or any party in interest in such plan has any control or significant financial interest, direct or indirect.

(e) The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this section, including exempting a plan from the requirements of this section in any case in which the Secretary finds that—

(1) other bonding arrangements would be adequate to protect the interests of the beneficiaries and participants, or

(2) each employer and employer representative, and any affiliate of such employer or employer representative (within the meaning of section 207(b)(7))—

(A) is obligated to provide protection to the plan against loss by reason of acts of fraud or dishonesty on the part of persons subject to subsection (a), and

(B) demonstrates reasonable assurance to the Secretary of fulfilling such obligation.

In any case in which, in the opinion of the Secretary, the administrator of a plan offers adequate evidence of the financial responsibility of the plan, or that other bonding arrangements would provide adequate protection for the beneficiaries and participants, the Secretary may modify or exempt such plan from some or all of the requirements of this section.

LIMITATION ON ACTIONS

SEC. 213. No action may be commenced under this Act with respect to a fiduciary's failure to meet any requirement of this title relating to fiduciary functions, or with respect to any other violation of this title, after the earlier of—

(1) six years after (A) the date of the last action which constituted a part of the failure or violation, or

(B) in the case of an omission, the latest date on which the fiduciary could have cured the failure or violation, or

(2) three years after the earlier of—

(A) the date on which the plaintiff had actual knowledge of the failure or violation, or

(B) the date on which a report from which the plaintiff could reasonably be expected to have obtained knowledge of such failure or violation was filed with the Secretary under this Act;

except that in the case of fraud or concealment, such action may be commenced not later than six years after the date of discovery of such failure or violation.

CERTAIN ACTIONS OF GOVERNMENT OFFICIALS NOT CONSIDERED FIDUCIARY FUNCTIONS

SEC. 214. Notwithstanding any other provision of this Act—

(1) no legislator shall individually be considered a fiduciary with respect to actions taken in a legislative capacity, and

(2) no person acting in a governmental capacity shall be considered a fiduciary with respect to actions taken regarding the establishment of plan provisions relating to benefits (including but not limited to eligibility, benefit levels, and the form and method of payment

of benefits), the establishment of funding levels for benefits or administrative costs, or the appropriation of funds to meet such funding levels for benefits or administrative costs.

TITLE III—ADMINISTRATION AND ENFORCEMENT

CIVIL ENFORCEMENT

SEC. 301. (a)(1) For purposes of any civil action brought under this section, the requirements of any law of a State or a political subdivision of a State described in section 102 shall be deemed to be requirements of this Act.

(2) A civil action may be brought by—

(A) any person described in section 110(b) in order to enforce a request for information provided for under this Act or to obtain the relief provided for under subsection (b)(1) of this section;

(B) the Secretary, the attorney general (or equivalent official) of a State in which the plan is established, or a participant, beneficiary, or fiduciary in order to—

(i) obtain appropriate relief under section 209,

(ii) enjoin any act or practice which violates any provision of this Act, or

(iii) obtain other appropriate equitable relief to redress any such violation or to enforce any such provision; and

(C) the Secretary or the attorney general (or equivalent official) of a State in which the plan is established to collect any civil penalty under subsection (b)(2) or (j) of this section or under section 112(a)(3)(B).

(b)(1) Any administrator who fails or refuses to comply with a request for any information which such administrator is required by this Act to furnish to a person described in section 110(b) or section 111(a) by mailing the material requested to the last known address of such person within sixty days after such request, may in the court's discretion be personally liable to such person in the amount of up to $100 a day from the date of such failure or refusal, unless such failure or refusal results from matters reasonably beyond the control of the administrator. The court may in its discretion order such other relief as it considers proper.

(2) In the case of a failure to file any form required under title I of this Act on the date and in the manner prescribed (determined without regard to any extension of time for filing), upon notice and demand by the Secretary there shall be paid by the person failing to file, $10 for each day during which such failure continues, but the total amount imposed under this subsection on any person for failure to file

any return shall not exceed $5,000. Such penalty shall be assessed by the Secretary unless it is shown that such failure is due to reasonable cause. For purposes of this subsection, the Secretary may assess such penalty for failure to file on any person who makes a timely filing which is incomplete in any material respect.

(c)(1) A plan may sue or be sued under this Act as a person. Service of summons, subpoena, or other legal process of a court upon a trustee or an administrator of a plan in the trustee's or administrator's capacity as such shall constitute service upon the plan. If a plan has not designated in its summary plan description an individual as agent for the service of legal process, service upon the Secretary shall constitute such service. The Secretary, not later than 15 days after receipt of service under the preceding sentence, shall notify the administrator, any named fiduciary, or any trustee of the plan of receipt of such service.

(2) Any money judgment under this Act against a plan shall be enforceable only against the plan as a person and shall not be enforceable against any other person unless liability against such person is established in such person's individual capacity under this Act.

(d)(1) Except as otherwise provided in this paragraph, the district courts of the United States shall have exclusive jurisdiction of civil actions brought under this Act. State

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courts of competent jurisdiction and district courts of the United States shall have concurrent jurisdiction of actions brought under subparagraphs (A) and (C) of subsection (a)(2) and actions brought under any law referred to in section 102.

(2) Notwithstanding section 94 of the National Banking Act (12 U.S.C. 94), in any case in which an action under this Act is brought in a district court of the United States, it may be brought in any district of the State where the plan is administered, where the breach took place, or where a defendant resides or may be found, and process may be served in any other district where a defendant resides or may be found.

(e) The district courts of the United States shall have jurisdiction without regard to the amount in controversy or the citizenship of the parties, to grant the relief provided for in subsection (a) of this section in any action.

(f) In any action brought under this Act by a participant, beneficiary, or fiduciary, the court—

(1) shall award a reasonable attorney's fee and costs of action to the plaintiff if the plaintiff prevails or substantially prevails in the action, unless the court in its discretion determines that the defendant acted in good faith and that such award will not further the purposes of this Act; and

(2) may in its discretion award a reasonable attorney's fee and costs of action to any defendant who prevails or substantially prevails in such action.

(g) A copy of the complaint in any action brought under this Act shall be served upon the Secretary by certified mail. The Secretary shall have the right in its discretion to intervene in any such action.

(h) Suits by an administrator, fiduciary, participant, or beneficiary of a plan to review a final order of the Secretary, to restrain the Secretary from taking any action contrary to the provisions of this Act, or to compel the Secretary to take action required under this Act, may be brought in any district court of the United States in the State where the plan has its principal office, or in the United States District Court for the District of Columbia.

(i) In all civil actions under this Act, attorneys appointed by the Secretary may represent the Secretary (except as provided in section 518(a) of title 28, United States Code).

(j)(1) In the case of a transaction by a party in interest which is prohibited by section 206, the Secretary or the attorney general (or equivalent official) of a State in which the plan is established may assess and collect a civil penalty against such party in interest involved in such transaction. The amount of such penalty may not exceed 5 percent of the amount involved, except that if the transaction is not corrected (in such manner and within such correction period as the Secretary shall prescribe by regulation), such penalty may be in an amount not more than 100 per centum of the amount involved.

(2) For purposes of this subsection—

(A) the term "amount involved" means, with respect to a prohibited transaction, the greater of the amount of money and the fair market value of other property given or the amount of money and the fair market value of other property received; except that, in the case of services, the amount involved shall be only the excess compensation;

(B) in the case of the initial 5 per centum penalty, the fair market value shall be determined as of the date on which the prohibited transaction occurs;

(C) in the case of the 100 per centum penalty, the fair market value shall be the highest fair market value during the correction period; and

(D) the term "correct" means, with respect to a prohibited transaction, undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than that in which it would be if the party in interest were acting in accordance with the fiduciary standards described in title II.

(k) The attorney general (or equivalent official) of a State may bring an action under subsection (a)(2)(B) or (a)(2)(C) (other than an action under any law referred to in section 102) only if such official first notifies the Secretary of the official's intention to bring such action, and the Secretary does not, within forty-five days, indicate its intention to bring an action under such subsections.

INVESTIGATIVE AUTHORITY

SEC. 302. (a) The Secretary shall have the power, in order to determine whether any person has violated or is about to violate any provision of this Act or any regulation or order thereunder—

(1) to make an investigation, and in connection therewith to require the submission of reports, books, and records, and the filing of data in support of any information required to be filed with the Secretary under this Act, and

(2) to enter such places, inspect such books and records, and question such persons as the Secretary may deem necessary to enable the Secretary to determine the facts relative to such investigation, if the Secretary has reasonable cause to believe there may exist a violation of this Act, or any rule or regulation issued thereunder or if the entry is pursuant to an agreement with the plan.

The Secretary may make available to any person actually affected by any matter which is the subject of an investigation under this section, and to any department or agency of the United States, information concerning any matter which may be the subject of such investigation.

(b) The Secretary may not under the authority of this section require any plan to submit to the Secretary any books or records of the plan more than once in any twelve-month period, unless the Secretary has reasonable cause to believe there may exist a violation of this Act or any regulation or order thereunder.

(c) For the purposes of any investigation provided for in this Act, the provisions of sections 9 and 10 (relating to the attendance of witnesses and the production of books, records, and documents) of the Federal Trade Commission Act (15 U.S.C. 49, 50) are hereby made applicable (without regard to any limitation in such sections with respect to persons, partnerships, banks, or common carriers) to the jurisdiction, powers, and duties of the Secretary or any officers designated by the Secretary. To the extent the Secretary considers appropriate, the Secretary may delegate the Secretary's investigative functions under this section with respect to insured banks acting as fiduciaries of plans to the appropriate Federal banking agency (as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))).

REGULATIONS

SEC. 303. (a) The Secretary may prescribe such regulations as the Secretary finds necessary or appropriate to carry out the provisions of this Act. Among other things, such regulations may—

(1) define accounting, technical, and trade terms used in such provisions; and

(2) provide for the keeping of books and records, and for the inspection of such books and records (subject to section 302 (a) and (b)).

(b) Before issuing any proposed regulations with respect to any matter under this Act, the Secretary shall—

(1) consult with employers, employer representatives, employee organizations, administrators, and other interested persons, and

(2) actively consider the advice and recommendations of the Advisory Council on Governmental Plans (established under section 307) with respect to such matter.

COOPERATION WITH STATES

SEC. 304. In order to avoid unnecessary cost to Federal, State, and local government agencies, the Secretary shall cooperate with State and local governments in the exchange of information and data on plans and shall make such arrangements as may be necessary to provide to and receive from State and local governments information and data at the lowest possible cost.

ADMINISTRATION

SEC. 305. (a) Subchapter II of chapter 5, and chapter 7, of title 5, United States Code (relating to administrative procedure), shall be applicable to this Act.

(b) No employee of the Secretary shall administer or enforce this Act with respect to (1) any plan under which the employee is a participant or beneficiary or (2) any employee organization of which the employee is a member.

INTERFERENCE WITH RIGHTS PROTECTED UNDER ACT

SEC. 306. It shall be unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which such participant or beneficiary is entitled under this Act, or for the purpose of interfering with the attainment of any right to which such participant or beneficiary may become entitled under this Act. It shall be unlawful for any person to discharge, fine, suspend, expel, or discriminate against any individual because such individual has given information or has testified or is about to testify in any inquiry or proceeding relating to this Act. The provisions of section 301 shall be applicable in the enforcement of this section.

ADVISORY COUNCIL ON GOVERNMENTAL PLANS

SEC. 307. (a)(1) There is hereby established an Advisory Council on Governmental Plans (hereinafter in this section referred to as the "Council") consisting of eleven members appointed by the President. Not more than six members of the Council shall be members of the same political party. The President shall annually designate one member to serve as chairperson. The initial members of the Council shall be appointed no later than one hundred and twenty days after the date of the enactment of this Act.

(2) Members shall be persons qualified to appraise the programs instituted under this Act.

(3) As determined by the President, the members of the Council shall be representative of the employees, the employee organizations, the employers, and the general public having a direct interest in the plans covered under this Act.

(4) Members shall serve for terms of three years except that of those first appointed, four shall be appointed for terms of one year, four shall be appointed for terms of two years, and three shall be appointed for terms of three years. A member may be reappointed. A member appointed to fill a vacancy shall be appointed only for the remainder of such term. A majority of members shall constitute a quorum and action shall be taken only by a majority vote of those present and voting. The Council shall meet at least twice each year

and at such other times as may be determined by the chairperson or as may be requested by the Secretary.

(b)(1) It shall be the duty of the Council to submit to the President and to each House of the Congress, no later than one year after the appointment of all initial members of the Council, a report which shall contain the Council's recommendations with respect to the initial implementation of the provisions of this Act, together with recommendations for such amendatory or other legislation as the Council finds necessary.

(2) It shall further be the duty of the Council to advise the Secretary with respect to the carrying out of the Secretary's functions under this Act and to submit to the Secretary recommendations with respect thereto. The Secretary shall actively consider any such recommendations of the Council prior to issuing regulations or otherwise carrying out its functions under this Act. The Secretary shall include each recommendation which the Secretary has received from the Council during the preceding calendar year in the annual report to the Congress submitted pursuant to section 308.

(c) The Council shall establish voluntary guidelines for plans with respect to matters for which requirements are not established by this Act. In establishing any such guidelines, the Council shall seek the advice of individuals and groups interested in such plans, including but not limited to employees, employee organizations, employers, administrators, and other interested persons, and may hold such hearings as it considers necessary in seeking such advice.

(d) The Secretary shall furnish to the Council an executive secretary and such professional, secretarial, clerical, and other services as the Secretary considers necessary for the Council to conduct its business. The Secretary shall call upon other agencies of the Government for statistical data, reports, and other information which the Council requests in the performance of its duties. The head of any such agency shall provide any data, report, or other information which is so requested.

(e) Members of the Council shall, for each day (including traveltime) during which they are attending meetings or conferences of the Council or otherwise engaged in the business of the Council, be compensated at a rate fixed by the Secretary which is not in excess of the daily equivalent of the annual rate of basic pay in effect for grade GS–18 of the General Schedule, and while away from their homes or regular places of business they may be allowed travel expenses, including per diem in lieu of subsistence, as authorized by section 5703 of title 5, United States Code.

(f) The Federal Advisory Committee Act (5 U.S.C. App.) shall not apply to the Council established by this section.

RESEARCH, STUDIES, AND ANNUAL REPORT

SEC. 308. (a)(1) The Secretary is authorized to undertake research and surveys and in connection therewith to collect, compile, analyze and publish data, information, and statistics relating to plans, including but not limited to—

(A) the effects of this Act upon the provisions and costs of plans,

(B) the role of pension plans in meeting the economic security needs of employees and their dependents, and

(C) the operation of pension plans including types and levels of benefits, degree of reciprocity or portability, financial and actuarial characteristics and practices, and methods of encouraging the growth of the pension system.

(2) The Secretary may, as the Secretary considers appropriate or necessary, undertake studies relating to pension and other employee benefit plans not subject to this Act.

(3) The research, surveys, studies, and publications referred to in this subsection may be conducted directly or indirectly through grant or contract arrangements.

(b) The Secretary shall submit annually a report to the Congress covering the Secretary's administration of this Act for the preceding year. The report shall include—

(1) an explanation of any exemptions under section 102 and any actions taken under section 115;

(2) the status of cases in enforcement status;

(3) recommendations received from the Advisory Council on Governmental Plans during the preceding year and an explanation of actions taken with respect thereto; and

(4) such information, data, research findings, studies, and recommendations in connection with the matters covered by this Act as the Secretary may find advisable.

(c) The Secretary shall publish not less than annually a report which shall include, but shall not be limited to, the following:

(1) the number of plans (including an explanation of any increase or decrease in the number of plans since the publication of the previous report);

(2) the number of active and nonactive participants of such plans;

(3) the amount of plan assets, income (including but not limited to employee and employer contributions and investment income), and expenses (including but not limited to benefit payments);

(4) the amount of plan assets by investment category; and

(5) an analysis of the actuarial position of defined benefit plans.

The information required by this subsection shall be shown by type and size of plan.

EFFECT ON OTHER LAWS

SEC. 309. (a) Except as provided in subsections (c) and (d), the provisions of sections 203 through 210 of this Act shall supersede all laws of any State or any political subdivision of a State insofar as such laws may now or hereafter relate to the subject matter of such sections as they apply to any public employee pension benefit plan described in section 4(a) and not exempt under section 4(b).

(b) Except as provided in subsections (c) and (d) and in section 102, the provisions of this Act other than the provisions referred to in subsection (a) shall supersede all laws of any State or any political subdivision of a State, but only insofar as such laws (1) may now or hereafter relate to the subject matter of such provisions as they apply to any public employee pension benefit plan described in section 4(a) and not exempt under section 4(b), and (2) prevent the application of such provisions.

(c)(1) Nothing in this Act shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

(2) For purposes of this subsection, neither a plan described in section 4(a) which is not exempt under section 4(b) nor any trust established under such a plan shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

(d) Subsections (a) and (b) shall not apply to any generally applicable criminal law of a State.

(e) For purposes of this section, the term "State law" includes all laws, decisions, rules, regulations, or other State action having the effect of law, of any State or political subdivision thereof. A law of the United States applicable only to the District of Columbia shall be treated as a State law rather than a law of the United States.

(f) Nothing in this Act shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in subsection (e)) or any rule or regulation issued under any such law.

(g) This section shall not apply with respect to any cause of action which arose, or any act or omission which occurred, before the effective date set forth in section 312(a).

AUTHORIZATION OF APPROPRIATIONS

SEC. 310. There are hereby authorized to be appropriated such sums as may be necessary to enable the Secretary to carry out the Secretary's functions and duties under this Act.

SEVERABILITY

SEC. 311. If any provision of this Act, or the application of such provision to any person or circumstances, shall be held invalid, the remainder of this Act, or the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

EFFECTIVE DATES

SEC. 312. (a) Except as provided in subsections (b) and (c), the preceding provisions of this Act shall take effect at the beginning of the second calendar year following the date of the submission of the report by the Advisory Council on Governmental Plans pursuant to section 307(b)(1).

(b) The provisions of this Act authorizing the Secretary to promulgate regulations shall take effect on the date of the submission of the report by the Advisory Council on Governmental Plans pursuant to section 307(b)(1).

(c) The provisions of sections 3(17), 305, 306, 307, 310, and 311 shall take effect on the date of the enactment of this Act.

Senator CHAFEE. Well, we welcome everyone here this morning.

This is the first hearing held in the Senate on the Public Employee Retirement Income Security Act, PERISA. We have two bills before the committee today: S. 2105 and S. 2106. Both have the same objectives, that is, to require basic reporting, disclosure, and fiduciary standards to be met by public employees' pension plans.

The standards will protect the rights and benefits of public employees as well as the interests of taxpayers who fund our Nation's public pension systems.

The reason for introducing two bills, which are similar but differ in several provisions, is to provide the Senate with an opportunity to consider more than one approach to the impending crisis in public pension funding.

As chairman of the Senate Finance Subcommittee on Savings, Pensions, and Investment Policy, as a former Governor, and as a citizen taxpayer, I have been concerned for a long time about the major problem facing State and local government retirement systems.

Whether you look to the comprehensive report on public plans issued in 1978 by the House pension task force or to a host of other private and government studies, it is clear that a crisis now exists in the operation of many State and local government pension plans.

Many plans are dangerously underfunded and have accumulated staggering amounts of unfunded liabilities.

All too frequently, important information on these plans' benefits and financial condition is not regularly disclosed to participants, to public officials, or to the taxpayers.

Fiduciary standards which guide the investment and management practices of many plans are wholly inadequate to safeguard assets; they come nowhere near what is expected, and in fact, required in the private-sector pension community.

Some pension experts have characterized the public pension situation as a ticking time bomb. While that may sound dramatic, it is clear we can no longer ignore a major area of national concern. The deteriorating financial condition of many public plans threatens not only the benefits of future retirees, but the pocketbooks of the taxpaying public.

Should a major State or municipal plan go broke, it is entirely possible that the Federal Government will be called upon for the bailout. We can avoid this situation if Congress will take steps now to establish the same minimum standards for public plans as it has set for private sector pension funds, in the areas of reporting, disclosure, and fiduciary conduct.

Such action was called for in the report of the President's Commission on Pension Policy, issued 1 year ago:

> 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.

During hearings my subcommittee held last May on the President's Commission report, this position was also strongly endorsed by the American Federation of State, County & Municipal Employees, AFSCME.

What does PERISA do?

It requires an annual report by each fund disclosing the plan's assets, liabilities, funding policy, changes in such policy, and transactions with any parties in interest.

It requires that pension funds hire an actuary to evaluate the plan at least once every 3 years.

It requires the plan administrator to provide information, on request of plan participants, regarding accumulated benefits and the extent to which benefits are vested.

It establishes fiduciary responsibilities similar to those under private pension plans. Assets would have to be held for the exclusive purpose of providing benefits to plan participants and defraying reasonable administrative costs.

It also establishes prohibited transaction rules similar to those under private plans. Fiduciaries would be prohibited from dealing in self-interest or any other interest but that of the beneficiaries. All investments and transactions must meet an adequate consideration test. Plans would be prohibited from investing more than 5 to 10 percent of assets in the employer's securities.

Some of the PERISA issues I expect to be widely discussed by the Senate are laid out in the differences between the two bills. One of those is the question of whether a single agency should be created to streamline the regulatory process which is now shared between the Internal Revenue Service and the Labor Department.

Another involves the kind of system we should establish for exempting State and local plans from PERISA jurisdiction. Should the States certify their own exemption or should the Labor Department retain that responsibility?

PERISA and the goal of restoring health to the Nation's public employees pension funds has been given top priority by such distinguished organizations as the Service Employees International Union, the National Education Association, the AFL-CIO Public Employee Department, and, as I have indicated, the American Federation of State, County, and Municipal Employees.

My bills mandate no added financial burdens on State and local governments, such as requiring certain funding levels be met. That is clearly a decision to be made at the local level.

We simply require that the financial condition of these funds be systematically reviewed and the information be made available to the public on a regular basis. It further requires that those who have management or administrative responsibility for public pension funds meet the same widely accepted standards of conduct currently expected of private pension fiduciaries.

PERISA is not, nor should it be, a partisan issue. It is sponsored in the House by ranking Members on both sides of the aisle. It should be supported by Republicans and Democrats and by conservatives and liberals alike, because it clearly is in the best interest of State and local governments, their employees and the public at large.

I urge my colleagues to join me in seeing this legislation through the Senate this year.

Now, I take it, Mr. Erlenborn is—oh, John is here. Will you not come up?

Our first witness is a very distinguished Congressman from Illinois, Congressman John Erlenborn, who has been active in this area in the House. We are delighted that you are here, Mr. Erlenborn, so why do you not just proceed?

STATEMENT OF HON. JOHN N. ERLENBORN, A U.S. CONGRESSMAN FROM THE STATE OF ILLINOIS

Representative ERLENBORN. Thank you very much, Senator.

Let me begin by saying that it is indeed a pleasure for me to participate in these hearings and to offer you my reasons for seeking the early enactment of PERISA legislation.

Senator Chafee, I want to compliment you for introducing S. 2105 and S. 2106, the Senate version of PERISA, and for holding these timely hearings. After a number of years of intensive study by both House and Senate committees and numerous other agencies, we can safely say that the need for PERISA legislation has been demonstrated repeatedly and convincingly.

I can report to you that we have completed our hearings on the counterpart bills in the House, H.R. 4928 and 4929, and that we intend to mark up the legislation at the earliest possible time after the Easter recess.

The chairman of my subcommittee, Philip Burton, and I have agreed to work vigorously on a bipartisan basis in order to complete action in the House within the next few months.

Given the interest in both the House and the Senate in enacting PERISA as well as other pension amendments relating to ERISA, I would encourage you, Mr. Chairman, and the other members of the Committee on Finance to complete your deliberations on PERISA and ERISA at the earliest possible time so that President Reagan can affix his signature to the pension legislation sometime this summer.

Mr. Chairman, the reaction to PERISA from some quarters undoubtedly will be, "Here come the Feds." I contend that such reactions are just hasty judgments stemming from a lack of information and understanding.

Emphatically, PERISA, in the general form in which it has been introduced in both the House and the Senate does not mean the imposition of burdensome regulations or the start of a great expansion in Federal powers.

To the contrary, PERISA represents a rationalization of existing Federal laws relating to public plans accompanied by deregulation in suitable areas. Let there be no misunderstanding, the bill is narrowly limited to reporting, disclosure, fiduciary, and tax matters.

Properly constructed, PERISA will result in enhanced accountability in public pension operations, greater protection and clarification of public employee pension benefit expectations, and the recognition that public pension funds belong to plan participants and should be invested for their exclusive benefit.

In sum, PERISA is the embodiment of the principle of good government carried out within the framework of a reasonable and appropriate State-Federal compact.

I firmly believe that it is the primary responsibility of State and local governments to set their own houses in order in the area of public pensions. However, as we know all too well, one of the weaknesses of our governmental structure is that we often act only in a crisis and then with too little information.

I fear that State and local inaction could lead to a national crisis precipitating congressional action. Political action at the State and local levels to correct the most difficult of the problems is not likely to happen unless there is complete and regular disclosure of the financial status of public plans to participants, taxpayers, and government decisionmakers alike.

To this end, PERISA establishes reporting and disclosure requirements which are considered minimum requirements among the various accounting, actuarial, and other municipal finance standard-setting organizations.

However, because we must recognize the importance of preserving and encouraging State regulation of such plans, PERISA in S. 2105 provides an exemption from the Federal reporting and disclosure rules in States where the Governor certifies that the law of the State sets substantially equivalent requirements.

Regardless of the current status of the laws in the various States, the important points to remember in connection with PERISA is that the States have it within their own control as to whether or not the public plans within their jurisdiction will be exempted from Federal regulation.

There is no dispute over the need for the reasonable standards embodied in PERISA; if there is any disagreement, it relates to the issue of at what governmental level the standards should be implemented. The hearings on PERISA which have been held over the past several years bear witness to this fact.

For example, the mayor of a major city testified on behalf of the National League of Cities that:

> We fully recognize that there are serious problems with public sector plans * * * and much remains to be done. We continue to believe that the best effort can be made at the State and local levels to solve public pension problems.

I basically agree with this mayor's logic, and this is why PERISA is structured to exempt plans from any Federal regulation where the States have demonstrated a willingness to at least begin to deal with their problems through meaningful reporting and disclosure.

Before problems can be solved, their existence and magnitude must be identified. There has to be an adequate framework for the continual monitoring of plan funding, investment, and other operations. Only after an adequate monitoring framework is established can employees, public officials, investors, and taxpayers become informed and be expected to create the public pressure necessary for problem solving.

Let us face it—there are numerous issues competing for the attention of public officials and there is precious little time for them to become expert in the esoterics of actuarial terminology and pension funding. An ongoing framework to monitor pension operations is absolutely essential if there is to be a full public understanding of such operations and if the reinvention of the wheel is to be avoided with each change in public administration.

One of the frustrations in putting such a framework into place under past PERISA bills was that it would put the Government in the position of telling the States do as I say, not as I do. This is no longer the case.

In 1978 Congress passed the legislation I introduced, Public Law 95-595, which brought the 65 or so Federal pension plans under reporting, actuarial, and auditing requirements similar to those of ERISA. I am hopeful that as information becomes available under this law, we will see the Congress giving more careful scrutiny to the operations of these systems as well.

Next, I would like to make several points in connection with the fiduciary standards under PERISA.

The bill includes the so-called exclusive benefit rule which is merely a continuation of the current standard which applies to all public employee retirement systems under the Internal Revenue Code. The bill also extends ERISA's Prudent Man Rule, to the operation of the State and local plans.

The lack of adequate fiduciary standards and codes of conduct under State and local plans is overwhelming. Even among the plans administered at the State level, 50 percent are not subject to customary fiduciary standards either by statute or case law.

A recent updating of the 1978 House Pension Task Force report shows that progress by State and local governments in this area has been slow and, in most cases, nonexistent.

The lack of adequate fiduciary guidelines has clearly presented a temptation to persons in some quarters to look to public pension plans as a source of funds to enable them to pursue their social causes.

The authors of a recently released Urban Institute study state that in their view:

> Legislative bodies should resist the temptation, which will increase as plan assets increase, to direct pension fund assets toward investments with high risk and/or lower return to promote social policies.

Those who manage pension fund moneys under ERISA plans are comfortable with and strong supporters of the ERISA exclusive benefit and prudent man rules. I know that many investment managers in the public plan arena are likeminded. They and I are of the opinion that the adoption of these ERISA fiduciary standards by State and local plans are absolutely necessary if public pension funds are going to be invested solely in the interest of plan participants and beneficiaries and not turned into political slush funds.

I would like to call your attention to the tax provisions under sections 1312 and 1313 of S. 2105. The inclusion of these provisions in the legislation is crucial to the rational treatment of public plans under Federal law.

They would eliminate the annual form 5500 report currently required under section 6058 of the Internal Revenue Code, for which a meaningful report is substituted under PERISA.

Also, the Internal Revenue Code is amended to unqualifiedly exempt the assets of public employee pension plans from Federal income and excise taxes.

In addition, the current provisions of the Code relating to plan benefit structure, for example, the section 415 limitation on benefits and contributions, the social security integration rules, the pre-

ERISA eligibility standards, et cetera, are made inapplicable to public employee pension plans.

Such provisions are now enforced only rarely or on a nonuniform basis and have the effect of unnecessarily putting plans and plan participants in tax jeopardy. The effect of the bill will be to remove the Federal Government from intruding into the areas of public plan operation best left to State and local jurisdiction; that is, the setting of benefits and contributions.

In other words, the bill is deregulatory in nature. It eliminates any opportunity for future conflicts between the Federal Government and State and local governments over benefits and contributions. This should set at ease the minds of those who view PERISA as just a means of getting the Federal camel's nose under the tent.

In fact, I want to assure you that I would oppose any Federal effort to extend to State and local plans funding, vesting, or other benefit or contribution related standards which might impinge on the sovereign rights of States and localities to establish and amend their employee pension benefits plans to set benefit and funding levels.

Even if other Congressmen were interested in pursuing funding standards at the Federal level—and I do not know of any supporters of PERISA having this in mind—it is my opinion that the imposition of such standards under the authority of the commerce clause would be unconstitutional. By limiting PERISA to the reporting, disclosure, and fiduciary areas there can be no question as to the constitutionality of the resulting act.

This issue has been addressed in detail during past hearings, and the unanimous opinion of the legal scholars has been that PERISA, as now limited, meets all the tests required to be constitutional.

Senator CHAFEE. That unanimity might be broken here today.

Representative ERLENBORN. Well, I would not be too surprised. But I think, Senator, that the vast majority of legal opinion is that the act as introduced would be constitutional.

For the sake of brevity, I have not included in my statement the many findings of facts which support the need for PERISA. At this time I would request that an article which shares some additional thoughts I have on PERISA be included in the record of this hearing.

Senator CHAFEE. This is an article you wrote, Congressman?

Representative ERLENBORN. Yes.

Senator CHAFEE. Fine; it will definitely go in the record.

[The statement of Mr. Erlenborn and the information referred to follows:]

Statement by
John N. Erlenborn
Member of Congress from Illinois
before the
Subcommittee on Savings, Pensions, and Investment Policy
of the
Senate Committee on Finance
Monday, March 29, 1982

THE PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT (PERISA)
(S. 2105 and S. 2106)

Good morning! Mr. Chairman and Members of the Subcommittee, let me begin by saying that it is indeed a pleasure for me to participate in these hearings and to offer you my reasons for seeking the early enactment of PERISA legislation. Senator Chafee, I want to compliment you for introducing S. 2105 and S. 2106 -- the Senate version of PERISA -- and for holding these timely hearings.

After a number of years of intensive study by both House and Senate committees and numerous other agencies, we can safely say that the need for PERISA legislation has been demonstrated repeatedly and convincingly. As a Member of the House Subcommittee on Labor-Management Relations, I can report to you that we have completed our hearings on the counterpart bills in the House (H.R. 4928 and H.R. 4929) and that we intend to mark-up the legislation at the earliest possible time after the Easter recess. The Chairman of my Subcommittee, Philip Burton, and I have agreed to work vigorously on a bipartisan basis in order to complete action in

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the House within the next few months. Given the interest in both the House and the Senate in enacting PERISA as well as other pension amendments relating to ERISA, I would encourage you, Mr. Chairman, and the other Members of the Committee on Finance to complete your deliberations on PERISA and ERISA at the earliest possible time so that President Reagan can fix his signature to the pension legislation sometime this summer.

Mr. Chairman, the reaction to PERISA from some quarters undoubtedly will be, "Here come the Feds." I contend that such reactions are just hasty judgments stemming from a lack of information and understanding. Emphatically, PERISA, in the general form in which it has been introduced in both the House and Senate does not mean the imposition of "burdensome" regulations or the start of a great expansion in Federal powers. To the contrary, PERISA represents a rationalization of existing Federal laws relating to public plans accompanied by deregulation in suitable areas. Let there be no misunderstanding, the legislation is narrowly limited to reporting, disclosure, fiduciary, and tax matters.

Properly constructed, PERISA will result in enhanced accountability in public pension plan operations, greater protection and clarification of public employee pension benefit expectations, and the recognition that public pension funds "belong" to plan participants and should be invested for their exclusive benefit. In sum, PERISA is the embodiment of the principle of good government carried out within the framework of a reasonable and appropriate State-Federal compact.

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I firmly believe that it is the primary responsibility of State and local governments to set their own houses in order in the area of public pensions. However, as we know all too well, one of the weaknesses of our governmental structure is that we often act only in a crisis and then with too little information. I fear that State and local inaction could lead to a national crisis precipitating Congressional action. Political action at the State and local levels to correct the most difficult of the problems is not likely to happen unless there is complete and regular disclosure of the financial status of public plans to participants, taxpayers, and government decisionmakers alike.

To this end, PERISA establishes reporting and disclosure requirements which are considered minimum requirements among the various accounting, actuarial, and other municipal finance standard-setting organizations. However, because we must recognize the importance of preserving and encouraging State regulation of such plans, PERISA in S. 2105 provides an exemption from the federal reporting and disclosure rules in States where the Governor certifies that the law of the State sets substantially equivalent requirements.

Regardless of the current status of the laws in the various States, the important points to remember in connection with PERISA is that the States have it within their own control as to whether or not the public plans within their jurisdiction will be exempted from federal regulation. There is no dispute over the need for

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the reasonable standards embodied in PERISA; if there is any disagreement, it relates to the issue of at what governmental level the standards should be implemented. The hearings on PERISA which have been held over the past several years bear witness to this fact. For example, the Mayor of a major city testified on behalf of the National League of Cities that: "We fully recognize that there are serious problems with public sector plans . . . (and) much more remains to be done. We continue to believe that the best effort can be made at the State and local levels to solve public pension problems."

I basically agree with this Mayor's logic, and this is why PERISA is structured to exempt plans from any federal regulation where the States have demonstrated a willingness to at least begin to deal with their problems through meaningful reporting and disclosure. Before problems can be solved, their existence and magnitude must be identified. There has to be an adequate framework for the continual monitoring of plan funding, investment, and other operations. Only after an adequate monitoring framework is established can employees, public officials, investors, and taxpayers become informed and be expected to create the public pressure necessary for problem solving.

Let's face it -- there are numerous issues competing for the attention of public officials and there is precious little time for them to become expert in the esoterics of actuarial terminology and pension funding. An ongoing framework to monitor pension

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operations is absolutely essential if there is to be a full public undertanding of such operations and if the "reinvention of the wheel" is to be avoided with each change in public administration. Only if PERISA is enacted will the needed framwork become universal.

One of the frustrations in putting such a framework into place under past PERISA bills was that it would put the Federal government in the position of telling the States "do as I say, not as I do." This is no longer the case.

In 1978, Congress passed the legislation I introduced (Public Law 95-595) which brought the 65 or so Federal pension plans under reporting, actuarial, and auditing requirements similar to those of ERISA. I am hopeful that as information becomes available under this law, we will see the Congress giving more careful scrutiny to the operations of these systems as well.

Next, I would like to make several points in connection with the fiduciary standards under PERISA.

The bill includes the so-called "exclusive benefit" rule which is merely a continuation of the current standard which applies to all public employee retirement systems under the Internal Revenue Code. The bill also extends ERISA's "Prudent Man Rule" to the operation of State and local plans.

The lack of adequate fiduciary standards and codes of conduct under State and local plans is overwhelming. Even among the plans administered at the State level, 50 per cent are not subject to customary fiduciary standards either by statute or case law. A recent updating of the 1978 House Pension Task Force report shows that progress by State and local governments in this area has been slow and, in most cases, nonexistent.

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The lack of adequate fiduciary guidelines has clearly presented a temptation to persons in some quarters to look to public pension plans as a source of funds to enable them to pursue their social causes. The authors of a recently released Urban Institute study state that in their view, "legislative bodies should resist the temptation, which will increase as plan assets increase, to direct pension fund assets toward investments with high risk and/or lower return to promote social policies."

Those who manage pension fund moneys under ERISA plans are comfortable with and strong supporters of the ERISA exclusive benefit and prudent man rules. I know that many investment managers in the public plan arena are like-minded. They and I are of the opinion that the adoption of these ERISA fiduciary standards by State and local plans are absolutely necessary if public pension funds are going to be invested solely in the interest of plan participants and beneficiaries and not turned into political slush funds.

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They would eliminate the annual Form 5500 report currently required under Section 6058 of the Internal Revenue Code, for which a meaningful report is substituted under PERISA. Also, the Internal Revenue Code is amended to unqualifiedly exempt the assets of public employee pension plans from Federal income and excise taxes.

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In addition, the current provisions of the Code relating to plan benefit structure (for example, the Section 415 limitation on benefits and contributions, the Social Security integration rules, the pre-ERISA eligibility standards, etc.) are made inapplicable to public employee pension plans. Such provisions are now enforced only rarely or on a non-uniform basis and have the effect of unnecessarily putting plans and plan participants in tax jeopardy. The effect of the bill will be to remove the Federal government from intruding into the areas of public plan operation best left to State and local discretion -- i.e., the setting of benefits and contributions.

In other words, the bill is deregulatory in nature. It eliminates any opportunity for future conflicts between the Federal government and State and local governments over benefits and contributions. This should set at ease the minds of those who view PERISA as just a means of getting the Federal "camel's nose under the tent." In fact, I want to assure you that I would oppose any Federal effort to extend to State and local plans funding, vesting, or other benefit or contribution related standards which might impinge on the sovereign rights of States and localities to establish and amend their employee pension benefits plans to set benefit and funding levels.

Even if other Congressmen were interested in pursuing funding standards at the Federal level -- and I do not know of any supporters of PERISA having this in mind -- it is my opinion that the

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imposition of such standards under the authority of the Commerce Clause would be unconstitutional. By limiting PERISA to the reporting, disclosure, and fiduciary areas there can be no question as to the constitutionality of the resulting Act. This issue has been addressed in detail during past hearings, and the unanimous opinion of the legal scholars has been that PERISA, as now limited, meets all the tests required to be considered constitutional.

For the sake of brevity I have not included in my statement the many findings of facts which support the need for PERISA. At this time I would request that an article* which shares some additional thoughts I have on PERISA be included in the record of this hearing.

*PERISA -- QUO VADIS? A Statement prepared by U.S. Rep. John N. Erlenborn of Illinois for the Pennsylvania State Association of Boroughs, Harrisburg, Pennsylvania, Friday, May 8, 1981.

Mr. Chairman, to summarize, the provisions of PERISA will establish important rights and protections for the participants and beneficiaries in public employee pension plans, will enable sponsoring governments, participants, and the taxpaying public to monitor the operation of such plans so as to reduce the likelihood of future financial crises, will minimize the possible adverse impact of the operations of such plans on Federal revenues and expenditures, and will eliminate certain currently applicable provisions of Federal law which have been found to be inadequate or inappropriate.

Through the enactment of PERISA legislation, we can enable State and local governments to better protect the pension expectations of their own employees and avoid the need for Federal crisis management at some future date.

PERISA -- QUO VADIS?

A Statement prepared by
U. S. Representative John N. Erlenborn
of Illinois
for the
Pennsylvania State Association of Boroughs
Harrisburg, Pennsylvania

Friday, May 8, 1981

Mention the word "PERISA" among a group of State and local government finance and pension officials and the debate begins. A first reaction will be near immediate recognition of the acronym as standing for the Public Employee Retirement Income Security Act -- the public pension counterpart to ERISA.

Undoubtedly, a second reaction for some will be, "Here Come the Feds." Emphatically, PERISA, in the form in which I proposed it, does not mean the imposition of "burdensome" regulations or the start of a great expansion in Federal powers. To the contrary, PERISA represents a rationalization of existing Federal laws relating to public plans accompanied by deregulation in suitable areas.

Properly constructed, PERISA will result in enhanced accountability in public pension plan operations, greater protection and clarification of public employee pension benefit expectations, and the recognition that public pension funds "belong" to plan participants and should be invested for their exclusive benefit. In sum, PERISA is the embodiment of the principle of good government carried out within the framework of a reasonable and appropriate State-Federal compact.

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What is the public pension problem? I have always liked the way a State Representative from Michigan summed it up:

> "Right now we have what amounts to a porkbarrel and piecemeal approach to pension modification. We modify one system without regard to fiscal consequences and then other systems want the same. This takes place in a totally political atmosphere without any regard to how the bill will be paid, by whom, and when. There is a total absence of logical structure. Employees had better get concerned that there is enough cash on hand to meet retirement needs and taxpayers had better get concerned with these massive and increasing debt obligations. We simply cannot continue in this helter-skelter fashion."

In a few words, this statement provides a clear, common sense insight into the problems of the public pension system; however, considerable documentation supports this contention.

A recent report on the funding of State and local pension plans issued by the General Accounting Office (GAO) concluded that pension reform on the State and local level is moving very slowly and significant improvement is not expected any time soon. The report pointed out the current deficiencies in funding practices. It also established the Federal interest in sound funding, in that grant funds and revenue sharing are increasingly relied upon to meet State and local pension plan costs.

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The report recommended that Congress keep a close watch on State and local efforts to improve plan funding to determine whether and at what point Congressional action might be necessary to prevent fiscal disaster and to protect the rights of employees and their dependents.

The GAO Report was preceded by the findings of the House Pension Task Force. Proposals affecting public pension plans were pending in Congress for about five years before it decided to get down to serious study of the subject.

In 1974 when ERISA was signed into public law, it directed four Congressional Committees to study public pension plans. At that time, pension legislation in the House fell under the jurisdiction of the Subcommittee on Labor Standards, of which I was the ranking Minority Member. We seized the initiative and ordered the Pension Task Force to study the public pension system.

Actually the word "system" is somewhat of a misnomer in this context because it implies a higher degree of order than presently exists in the public pension universe.

The Pension Task Force study explored this universe for the first time. It covered the 68 or so Federal pension plans, as well as the nearly 7,000 State and local retirement systems. Prior to these findings, only one-third of the State and local total had been documented in previous reports to the Bureau of the Census.

We learned that the great majority of public plans are relatively small, with 80 per cent having fewer than 100 active members. However, most of the State and local employees participate in larger

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plans. Approximately 400 public plans had more than 1,000 active members, representing only 6 per cent of the total number of plans but covering over 95 per cent of all State and local government employees.

The Pension Task Force Report looked at much more than just these numbers. It is impossible in this article to present all aspects of the public pension issue which were covered in the nearly 1,000 page report. However, we can draw together some of the major findings which have verified the need for State and local pension plan reform.

First of all, it can generally be stated that the relative benefit levels for most public employee pensions rank in the Cadillac division when compared to their counterparts in the private sector.

A conservative estimate shows that at least one-half of the full-career State and local government employees retire on pension plus Social Security income equaling 100 per cent or more of their pre-retirement net income. Nearly all career public employees can expect their pension income to replace at least 50 per cent of their pre-retirement net income.

Admittedly, State and local employees generally contribute to their plans while employees in the private sector usually don't; however, I don't think anyone would argue that these figures indicate that public pensions are not extremely generous, to say the least. I'll ignore the question of whether it is equitable for anyone to retire with 100 per cent of earnings, let alone fair to ask the taxpayer to support such benefit levels.

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The Pension Task Force Report also documented the administrative laxity which exists in many State and local pension plans. In many plans, the lack of clear-cut pension policy and control has led to favoritism and abuse, particularly in the granting of disability pensions. A county-run plan in one State was actually forced into receivership because of such abuse.

The Report also pointed to a virtual absence of clear codes of conduct for fiduciaries within the public pension system. Even among the plans administered at the State level, 50 per cent are not subject to customary fiduciary standards either by statute or case law. Predictably the result has been excessive conflicts of interest and instances of imprudent actions and self-dealing.

As a general rule, public pension plans do not operate within the financial and accounting procedures normally applicable to private pension plans. Only 40 per cent of the large State and local plans are audited annually by an external, independent auditor. Some of the rest are audited by related government agencies, but at least one-third of the large plans are not audited on an annual basis at all. Some of the largest plans are audited only once every four or five years.

The Task Force found that 60 to 70 per cent of all State and local systems either do not know or do not disclose the market value of plan assets.

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Numerous State and local pension plans have drifted into serious financial straits because they have been immune from regular and complete reporting of the plan's status to participants, taxpayers, and government decisionmakers. Spared public scrutiny, many public plans have engaged, both unwittingly and intentionally, in questionable management practices.

Like the GAO report which followed, the House Pension Task Force study found serious weaknesses in the funding of State and local pension plans.

Any legitimate attempt to anticipate future pension costs involves making assumptions about the future, taking into account expected retirement rates, death rates, disability rates, termination rates, future salary increases and future investment yields. Yet, the Task Force found that only 45 per cent of all public pension plans fund on an "actuarial" basis and the reasonableness of the assumptions used by some of these plans is highly questionable.

Roughly 17 per cent of all public plans do not pre-fund but continue to rely on the discredited "pay-as-you-go" approach, funding benefits only as they become due. The remaining plans fund on a basis somewhere between "pay-as-you-go" and "actuarial."

Almost one-fourth of all State and local pension plans have never even had an actuarial evaluation and one-third of the plans have not had one within the past five years.

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Due to the lack of actuarial funding practices, a realistic assessment of true pension costs is virtually impossible. As a result, too many State and local plans are not setting aside sufficient funds to pay for future benefits. Not surprisingly, the majority of public plans are already experiencing rising pension costs as a percentage of payroll.

When a public pension plan finds itself in trouble, it has two unpleasant options. First, it can seek a bail-out from the general fund, courtesy of the taxpayers. This is what frequently happens with plans that are funded on the "pay-as-you-go" basis.

The other alternative, which is not mutually exclusive, involves curtailing the benefits expected by plan participants. While there is no evidence that public employees have suffered pension losses as a result of a plan termination, there have been several situations where some workers have suffered temporary, and in a few cases, permanent, benefit reduction when a State or local plan has slipped into insolvency or near-insolvency; Hamtramck, Michigan, and Toledo and Lakewood Ohio are often cited as examples.

We have seen downward adjustment not only at the State and local level, but in the Federal Civil Service Retirement System and the Social Security System, as well.

Downward adjustment in public pension formulas is more likely to occur at the State and local level because it is easier to pull off from a political standpoint. In many instances, plan disclosure to

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participants is inadequate or non-existent. The Task Force determined that less than half of all public plans make a regular practice of distributing and updating plan descriptions in one form or another.

Many State and local workers simply don't know what they are entitled to and are unable to assess the financial operations of their plan because of the lack of information. State and local participants are unappreciative of the true level of pension costs, and are unaware of the conditions leading to benefit reductions.

I have just outlined the most serious problems of the public pension system, as documented by the 1978 Pension Task Force Report. An objective reading of this report should convince all but the rank skeptic of the need for immediate and responsible action on the part of State and local governments, as well as the Federal government.

I would be the last person to call for the regulation of State and local matters if I didn't think it was absolutely necessary and fully justified.

Let there be no doubt about it, the Federal government has a substantial interest in how State and local plan funds are invested and how well they are funded. About one billion dollars or approximately one-tenth of the employer contibutions to State and local plans are attributable to Federal grant moneys. This percentage may double to 20 per cent if Federal revenue sharing moneys are also taken into account.

It is worth noting that the State share of revenue sharing was and may continue to be cut back in last year's Congressional deliberations. This action serves warning that State and local plans must be prepared to stand on their own. PERISA will encourage State and local pension funds to be self-sustaining.

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The Federal interest in public pension plans also applies in the rea of taxation. State and local plans benefit from special treatment from the Internal Revenue Service (IRS). Participants in tax-qualified public plans are exempted from paying income tax on the government contribution to their pension fund. In addition, the investment earnings of qualified State and local systems, approximately 10 billion dollars per year, escape Federal taxation.

So, Federal authority to require State and local plans to meet certain IRS standards in order to receive preferential tax treatment exists, but is not uniformly exercised.

Another reason why the Federal government must be concerned with the problems of State and local pensions, is that the Feds will be called in if the larger State and city funds are about to go under.

During the 1970s the New York City Municipal pension plans were finally caught up in the financial web the Big Apple had spun for itself. In addition to the direct Federal bailout, Congress had to pass special legislation to allow the pension fund to purchase the poorly rated New York City Bonds. If the City should default, massive benefit reductions would be inevitable. For this reason, the pressure on the Federal government to continue to subsidize New York City was drastically heightened.

Actually the City's pension fund was in no shape to make such agnanimous gestures. Elected officials had been giving away Fort Knox several times over in order to quietly settle wage disputes.

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Salary increases would have required politically unpopular tax hikes. Fatter pension benefits, on the other hand, delayed the problem for 20 years or so. Through inadequate funding, these officials were leaving a legacy of astronomically high tax bills to their children and grandchildren.

Obsolete actuarial standards also contributed to the plan's underfunded status. Actuarial assumptions used in New York included pre-1929 mortality rates.

Unless it takes positive steps to strengthen the public pension system, the Federal government may someday find itself supporting municipal pension plans in Detroit, Chicago, Los Angeles or possibly some cities in Pennsylvania.

The broad authority for Federal involvement in the public pension system is grounded in the constitutional authority to regulate commerce.

Unquestionably, the public pension system has a vast influence on our national economy. The nearly 200 billion dollars in assets currently held by State and local funds and their 18 plus billion dollars annual contribution represent more than one-half of the total funds held by private pension plans. Together these public and private pension funds constitute the largest single source of investment capital in this country. The benefit payments made by State and local systems add over 15 plus billion dollars annually to the consumption and savings elements of the economy.

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Finally, Federal concern with deficiencies of the public pension system is warranted by the general public interest. With few exceptions, public employees are not protected against pension benefit reductions, forfeitures or defaults, while their counterparts in the private sector do enjoy such safeguards.

At the same time, we find that the high costs deriving from questionable practices in the past are threatening the stability of many public pension funds. The burden of floundering pension plans will ultimately be borne by the Federal, as well as the State, taxpayer.

It is time to institute a "preventive defense." To prevent the public pension problem from growing still further, certain steps must be taken now. I believe that the 1981 version of PERISA which I will introduce shortly embodies these urgently needed steps.

Before giving the details of PERISA, a few words about the philosophy behind the bill are in order. The PERISA bill emphasizes reporting and disclosure requirements, and does not impose Federal standards for funding and vesting. Accurate reporting and disclosure will provide the information and incentives necessary for States and localities to put their own houses in order. Most State and local plans get into trouble because they have been immune from complete and regular disclosure of the plan's status, not only to participants, but to government decisionmakers and taxpayers as well.

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Recognizing the importance of preserving and encouraging State regulation of public pension plans, PERISA provides an exemption from Federal regulation in the area of reporting and disclosure where State law sets substantially equivalent requirements.

PERISA does not impose Federal regulation over local prerogatives in funding, vesting or employee participation.

The philosophy underlying the current version of PERISA evolved gradually through a series of similar proposals which I have been involved with over the years.

In 1975, not long after the House Pension Task Force began its study of the public pension system, I joined with the then Chairman of the Labor Standards Subcommittee, Pennsylvania Congressman John Dent, in introducing an early version of PERISA. This bill was largely a rewrite of the ERISA legislation passed a year earlier, but it applied to public plans instead. The bill was meant to serve as a focus for committee hearings on the public pension problem, rather than a legislative vehicle to be enacted into law.

We received testimony and exchanged views with more than 39 organizations and individuals representing virtually every aspect of government pension plans -- employee organizations, public plan administrators, state legislators, mayors, and others.

Congressman Dent and I introduced the second version of PERISA one year later, in 1976. The major difference was that the 1976 version did not prescribe funding or vesting standards for State and local plans; nor did it attempt to dictate plan coverage.

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One of our frustrations with the 1976 PERISA bill was that it put the Federal government in the position of telling the States "Do as I say, not as I do." Our Subcommittee could not draft pension legislation for Federal employee plans. That came under the jurisdiction of the Post Office and Civil Service Committee.

The Federal government probably needed more guidance than State and local plans. In 1974, the Civil Service Retirement Fund had an unfunded liability of 77 billion dollars, mroe than the entire unfunded liability of all of the private plans, which at the time covered ten times as many people.

Finally, in 1978, Congress passed Public Law 95-595 which brought the 68 or so Federal pension plans under reporting, auditing, and actuarial requirements similar to those of ERISA. This year will mark the first time that the financial condition of all Federal plans will be available to the American public.

The Public Employee Retirement Income Security Act of 1981, represents the culmination of over five years of in-depth consideration of the public pension problem and the measures by which it can be solved. It will enable us to move another step closer to developing a rational and effective retirement income policy that ensures the economic security of our elderly citizens.

Virtually all public employee pension benefit plans would be covered under the provisions of the current version of PERISA. Important exemptions include but are not limited to deferred compensation plans for high level employees, severance pay plans, individual retirement accounts, and 403(b) annuity plans.

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The bill provides an exemption from the reporting, disclosure, bonding, and related enforcement provisions if a State establishes substantially equivalent requirements for the public plans within its jurisdiction and the Governor of the State certifies as much.

ERISA-like reporting and disclosure requirements will be applicable to covered public plans. Plan participants and beneficiaries are entitled to an accurate description and complete summary of their rights and obligations under the plan. Such on initial summary plan description, which is to be written in plain English, must be updated every ten years to include interim changes.

Upon written request a statement must be furnished within 60 days providing a participant with information pertaining to total accumulated contributions, pension benefits and vesting status. Information on a participant's pension benefits and rights is to be furnished whenever a participant terminates, makes a benefit election, or receives a benefit or return of contribution payments.

Disclosure to the public and other interested parties is to be achieved by making copies of the summary plan description, the annual report, the bargaining agreement, and other documents available at the principal office of the administrator. Copies of the same material will be filed with a single Federal agency, known as the Employee Benefit Administration.

The plan administrator must also prepare an annual report to include appropriate financial statements, party-in-interest transactions, an actuarial statement, and information on terminated vested benefits. The plan must be audited by an "independent accountant"

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each year and a bona fide actuarial valuation must be performed every three years. The independent accountant may be a State auditor if certain conditions are met.

Smaller public plans with fewer than 100 employees will be allowed to file simplified annual reports.

PERISA also establishes standards for fiduciaries of public plans. Every plan must be established and maintained pursuant to a written instrument. Plan assets must be held in trust and used for the exclusive benefits of participants and beneficiaries.

The Act defines who is considered a fiduciary, but I am sure many of you are more interested in the definition of who is not a fiduciary. A person acting in his or her governmental capacity or a legislator acting in a legislative capacity with respect to the setting of benefit and contribution levels is not considered a fiduciary.

Certain types of transactions between the plan and a party-in-interest are specifically prohibited under the bill. The act protects plans against loss by reason of fraud or dishonesty by requiring fiduciaries who handle funds to be bonded.

Compliance with the provisions of the Act is enforced through appropriate civil remedies and access to Federal and State courts.

The bill eliminates the annual Form 5500 report currently required under Section 6058 of the Internal Revenue Code, for which a meaningful report is substituted under PERISA. Also, the Internal Revenue Code is amended to unqualifiedly exempt the assets of public employee pension plans from Federal income and excise taxes.

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In addition, the current provisions of the Code relating to plan benefit structure (for example, the Section 415 limitation on benefits and contributions, the Social Security integration rules, the pre-ERISA eligibility standards, etc.) are made inapplicable to public employee pension plans. Such provisions are now enforced only rarely or on a non-uniform basis and have the effect of unnecessarily putting plans and plan participants in tax jeopardy. The effect of the bill will be to remove the Federal government from intruding into the areas of public plan operation best left to State and local discretion -- i.e., the setting of benefits and contributions.

In other words, the bill is deregulatory in nature. It eliminates any opportunity for future conflicts between the Federal government and State and local governments over benefits and contributions. This should set at ease the minds of those who view PERISA as just a means of getting the Federal "camel's nose under the tent." In fact, I want to assure you that I would vigorously oppose any Federal effort to impose on State and local plans funding, vesting, or other benefit or contribution related standards which might impinge on the sovereign rights of State and localities to establish and amend their employee pension benefits plans to set benefit and funding levels.

Even if other Congressmen were interested in pursuing funding standards at the Federal level -- and I do not know of any supporters of PERISA having this in mind -- it is my opinion that the imposition of such standards under the authority of the Commerce Clause would be unconstitutional.

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Before closing, I would like to make several more points in connection with the fiduciary standards under PERISA.

First, the bill includes the so-called "exclusive benefit" rule which is merely a continuation of the current standard which applies to all public employee retirement systems under the Internal Revenue Code. The bill also extends ERISA's "Prudent Man Rule" to the operation of State and local plans.

The lack of adequate fiduciary standards and codes of conduct under State and local plans is overwhelming. A recent updating of the 1978 House Pension Task Force report shows that progress by State and local governments in this area has been slow and, in most cases, nonexistent.

The lack of adequate fiduciary guidelines has clearly presented a temptation to persons in some quarters to look to public pension plans as a source of funds to enable them to pursue their social causes. The authors of the recently released Urban Institute report, <u>The Future of State and Local Pensions</u>, state that in their view, "legislative bodies should resist the temptation, which will increase as plan assets increase, to direct pension fund assets toward investments with higher risk and/or lower return to promote social policies."

Those who manage pension fund moneys under ERISA plans are comfortable with and strong supporters of the ERISA exclusive benefit and prudent man rules. I know that many investment managers in the public plan arena are like-minded. They and I are of the opinion that the adoption of these ERISA fiduciary standards by State and local plans are absolutely necessary if public pension funds are going to be invested solely in the interest of plan participants and beneficiaries and not turned into political slush funds.

To summarize the intent of PERISA, the provisions of the bill will establish important rights and protections for the participants and beneficiaries in public employee pension plans, will enable sponsoring governments, participants, and the tax-paying public to monitor the operation of such plans so as to reduce the likelihood of future financial crises, will minimize the possible adverse impact of the operations of such plans on Federal revenues and expenditures, and will eliminate certain currently applicable provisions of Federal law which have been found to be inadequate or inappropriate.

Through the enactment of PERISA legislation, we can enable State and local governments to better protect the pension expectations of their own employees and avoid the need for Federal crisis management at some future date.

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Senator CHAFEE. It will be helpful to us. You have done some research into the status of various State funds.

Representative ERLENBORN. Yes; we had our subcommittee or task force report in 1978. That was a result of an extensive study of State and local public pension plans, really, the definitive work in this area. It is very revealing as to the lack of fiduciary standards, and in many cases the lack of accountability to the sponsors and beneficiaries of the pension plans.

Senator CHAFEE. What would you say to the criticism that we are hardly in a position in the Federal Government to tell anybody anything about pension plans, since our pension plans have over $1 trillion dollars in unfunded liabilities and the three social security funds have close to $6 trillion in accrued liability?

Representative ERLENBORN. Well, we have there, of course, a great mixed bag of benefits. Some we refer to, like social security, as though they were pension benefits. They never were designed to be pension benefits. They never were designed to be, as some people say, actuarially sound or funded.

Social security is simply an income transfer scheme, taking money from those who are working today and transferring it to those who are aged, disabled, widowed, orphaned, and so forth. So that social security cannot really be viewed in the sense of being underfunded, because it never was intended to be funded.

The military retirement system, by design, is totally unfunded. Many people are unaware of the fact that it is unique, that the total cost of pension benefits for the military is included in the annual defense appropriation. It is a very substantial part of the Defense Department appropriation every year.

No other agency of the Federal Government that I can think of has its pension costs in its annual operating budget.

Senator CHAFEE. Well, let us just take the Post Office, the civil servants.

Representative ERLENBORN. Well, I think the answer to the criticism, Senator, is that we know the condition of our Federal plans because we have passed legislation requiring the same sort of reporting and disclosure and actuarial evaluation for our Federal plans that we are now asking State and local governments to accept under PERISA.

In other words, we have done it for the Federal plan so that we now know the size and the scope of the problems in the Federal system, and we are seeking PERISA so that we can have the same information for State and local plans.

Senator CHAFEE. What do we say to the argument that your bill sets up a new agency?

Representative ERLENBORN. Senator, I was very reluctant to come to the conclusion that we needed a separate new agency, the Employee Benefits Administration, until we had had some few years of experience under ERISA. I have seen the confusion that results from having three separate agencies—PBGC, the Department of Labor, and the Treasury Department—enforcing the provisions of ERISA.

I have come to the conclusion that a single agency, incorporating the regulatory authority, the administrative authority of all three of these agencies would be streamlined, less costly, and certainly more responsive to the pension community.

I think that there would actually, rather than be an additional cost of a new agency, there would actually be savings by reducing the number of people needed to administer PERISA.

Senator CHAFEE. What about the fact that—and I have heard people on our State level say that they already file a form and nobody pays any attention to it. What is that, form 550?

Representative ERLENBORN. That is why we are abolishing that in the PERISA legislation.

Senator CHAFEE. But the argument is still there. They file this form; it comes in; and they are not sure anybody even looks at it. Who cares? Will anybody care under this business that we are proposing?

Representative ERLENBORN. Well, the fact is not all reporting is created equal. Some reporting is unnecessary, and I think the form 550 is a good example of that. But the kind of actuarial and accounting reporting required under PERISA will be meaningful.

I would say many of those who object to the reporting—and I would not want to throw them all into the same pack—are people who do not want the public to find out the facts about public pension plans because those facts would be frightening as to how poorly funded they are and how poorly invested, in many cases, those public plan funds are.

Actually, this reporting will give an opportunity to lawmakers and the public alike to find out the facts that they should have available to them about the management of the public funds.

Senator CHAFEE. There is one other factor that I see in my own State as regards the virtues of disclosure. There is a temptation now to shove any deserving politico into the pension system somehow, State or local, because everybody likes pensions, but with little consideration that these funds are in desperate shape.

Maybe if the public knew how unsound these pensions were, they would not countenance this stashing away of party faithful with various outrageous pension benefits to which the truly deserving were not entitled but to which by special law others have become entitled.

Representative ERLENBORN. I think you are exactly right. Those politicos and others who may be appointed to become managers of these funds very often are in a position of not even knowing what their responsibilities are. Most States do not have clear fiduciary standards for the guidance either of the public officials who serve on these funds or those who are monitoring their activities.

Senator CHAFEE. Is there a model law drawn up that a State could adopt? You mentioned something about not wanting to reinvent the wheel. What can the States do or the municipalities? Well, actually, let us start with the States. Is there some action they can take and say this will meet what Mr. Erlenborn and Mr. Burton and others wish?

Representative ERLENBORN. I am not aware of anything such as the model law proposed by the National Commission on Uniform State Laws. But certainly, ERISA itself is a model in imposing the prudent man rule, the exclusive benefit rule, and so forth. States, if they wish to, already could have looked to ERISA as a model and could have adopted fiduciary standards, reporting and disclosure standards.

I think it is very instructive and very revealing that in the past 7-plus years since ERISA was passed, that possibility has almost been totally ignored, and the States have not moved forward.

Senator CHAFEE. Maybe, if we adopt this legislation, the National Conference of State Legislators or somebody would probably come up with a model statute.

Representative ERLENBORN. I think they likely would. I would like to reiterate, one of the provisions of PERISA included in one of the versions that you and I have introduced would encourage the States to do this since, if they acted on their own, they would then opt out from Federal regulation.

This is meant to be, rather than the imposition of new regulatory authority from the Federal Government on the States, a catalyst to bring about the kind of State action that should have occurred already.

Senator CHAFEE. Yes; it seems to me this catalyst notion would be truly our goal. Would it not, behoove us to get us out of the business completely, to have the States adopt some kind of legislation similar to what we wish? Then, we would be out?

Representative ERLENBORN. Senator, I think it is interesting to note that in the field of regulation of insurance, the same sort of thing was done many years ago. We have a basic Federal regulation of insurance companies in Federal law with the authority for States to opt out by enacting their own State insurance regulation. There is no State that has failed to do so. Every State now has its own, and has had for many years, its own regulation of insurance, which means the Federal law is not needed. It did act as a catalyst, and I think that is exactly what could happen with PERISA.

Senator CHAFEE. Well, that is a good illustration. The same thing happened with the Coast Guard regulations and small boats. The States adopted regulations.

Well, thank you very much, Congressman. We appreciate your taking the time to be here.

Representative ERLENBORN. Thank you.

Senator CHAFEE. Now, ladies and gentlemen, this is the way we are going to handle these hearings. What I am going to do is outline the time that everybody will be on. You may be on a shorter time, but you will not be on a longer time.

So the first panel, if you would come on up, Mr. Sweeney, Mr. Masten, Ms. Tarr-Whelan, and Mr. Schaitberger. This panel will be on for 30 minutes; in other words, until 10:35. The next panel will be on from 10:35 until 11:05; that is the panel of Mr. Clark, Mr. Natale, and Ms. Kreamer. The next panel after that, Mr. Hacking and Mr. Spaniola, will be on from 11:05 until 11:30. And the final panel of Governor Peabody, Mr. Klausner and Mr. Schotland, will be on from 11:30 to 11:55.

So there you are. We have ended up with more. Let us see, we called four and got seven.

Mr. SWEENEY. Senator, in addition to the members of the panel we also have some staff members who are here with us to assist.

Senator CHAFEE. All right. Now you have 30 minutes. First, Mr. Sweeney.

STATEMENT OF JOHN J. SWEENEY, PRESIDENT, SERVICE EMPLOYEES INTERNATIONAL UNION; AND EXECUTIVE VICE PRESIDENT, PUBLIC EMPLOYEE DEPARTMENT, AFL-CIO

Mr. SWEENEY. Senator, I am pleased to be here.

Senator CHAFEE. If you would summarize your statements, otherwise you are going to eat into the times of those who follow you, to their consternation, perhaps. Go ahead.

Mr. SWEENEY. I believe that we each have relatively short statements, and we will keep to the time contraints which you have instructed us.

I am pleased to have the opportunity to appear before the committee today to provide you with the Public Employees Department views on S. 2105 and S. 2106. We would first like to commend you for your efforts in introducing the Public Employee Retirement Income Security Act legislation. We at the Public Employees Department welcome your concern and the leadership you have provided to us this year in taking a meaningful step toward protecting the retirement benefits of public workers.

The PED believes that the regulation, administration, and financial security of public pension funds is a national concern. Today there are over 6,600 separately administered State and local government retirement plans, with total membership exceeding 11 million workers and retirees. The assets of these funds are currently valued at over $200 billion and are expected to increase to $1 trillion within the next 15 years.

The administration and the investment of that much money will necessarily exert a major influence on the structure and performance of the United States economy. For this reason, Federal action is required and justified to resolve the serious deficiencies which are prevalent among government pensions as they exist today.

Public workers have a fundamental right to know about their retirement systems, but are often kept in the dark. In a 1981 report the Urban Institute found reporting and disclosure for most State and local government plans to be inadequate.

As many as 40 percent of State and local governments do not automatically furnish their plan participants with plan descriptions. 18 percent do not even provide this information on request. Although many government jurisdictions do have some reporting and disclosure laws, the regulations are sporadic and noncomprehensive.

What information is supplied by these government plans is either too brief or too detailed to be of any practical use to the average plan participant or beneficiary.

Every day more of our members are faced with the painful reality that the job security which was once found in public service is being threatened by economic and fiscal distress and antigovernment attitudes. Our workers will be relying more and more on what they have been setting aside for retirement as a last chance to achieve income security.

PERISA would mandate that the participants be automatically furnished with copies of their plans and other important information that would help them plan for the future. Widespread public disclosure is necessary to curb the potential for administrative abuse, abuse which victimizes plan participants and the taxpaying public.

A widely cited study of the asset management practices of State and local pension funds has documented the extent to which conflicts of interest exist in public employee pension plans. Unfortunately, large segments of the assets held by pension funds are managed in the interest of those who control the funds rather than in the interest of those for whom the funds are intended to provide benefits.

The PED strongly supports the regulation of fiduciary responsibilities. The lack of proper oversight can result in investment practices which yield poor returns or which support ventures operating contrary to the beneficiaries' best interest. During the period from 1971 to 1980, the median annual rate of return on total public retirement funds was 5.8 percent; and in 1981 the annual median return was only 3.3 percent. These figures are according to A. G. Becker, Inc., a leader of fund-investment performance measures.

We are not suggesting that the return rate is a direct indication of the lack of proper fiduciary management, but such a low rate of return during a 10-year period of substantially high inflation would make one question the investing practices.

We support the general provisions contained in both S. 2105 and S. 2106. However, we strongly prefer, and would suggest that the committee adopt S. 2106. This is particularly true in the area of requirements and prohibitions relating to fiduciary functions.

It is apparent to us that these requirements are much stronger in S. 2106 than in S. 2105. Not only are fiduciaries prohibited from using plan funds for their own personal interest and gain, but they are also prohibited from any sales, lending, or servicing transactions that would be inconsistent with proposed requirements that fiduciaries act in a prudent manner. We cannot allow our members' retirement funds to be used in any way that would not benefit them to the fullest.

The PED supports the establishment of an advisory council on governmental plans as a means toward establishing minimum benefit guidelines for government-service retiree plans. The public, it appears, is under the gross misconception that public employees make out like bandits when the time comes for them to draw a pension. The following facts may correct that perception.

First, the average monthly benefit for State and local government employees was only $298 in fiscal year 1976-77, when the most recent calculation of this kind was released. This compares to a poverty threshold level for a retired couple of $296 per month for the same period.

Second, more recent figures from the Census Bureau reveal that many pension plans offered monthly benefit payments which were less than $200—and even less than $100—in fiscal year 1980.

Third, the President's Commission on Pension Policy reported that in 1978 the average annual benefit paid from a public pension plan was $4,957 for married couples. These meager income statistics do not even take into consideration the fact that over 90 percent of public pension plans are contributory, compared to only 10 percent of private sector plans.

The establishment of an advisory council, we hope, will serve to bring about some standards in the area of benefit structure.

Senator CHAFEE. OK, Mr. Sweeney, your time is up. Do you want to just summarize that last page? Every minute you go over eats into your fellow colleagues' time.

Mr. SWEENEY. We would prefer the provisions as provided in S. 2106, which give the Secretary of Labor the authority to promulgate and administer regulations to govern the administration of the act.

We are committed to supporting the AFL-CIO position, which I believe you are familiar with. We have made the enactment of PERISA one of the highest legislature goals of the 1980's. And we are committed to support that.

We are opposed to the establishment of an Employee Benefit Administration, as provided in S. 2105.

Senator CHAFEE. In other words, you would have it done by keeping the Labor Department and the IRS both in it?

Mr. SWEENEY. Yes.

Senator CHAFEE. All right. We will have a chance to ask some questions. Thank you, Mr. Sweeney.

[Statement of Mr. Sweeney follows:]

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KENNETH T. BLAYLOCK, President
JOHN F. LEYDEN, Executive Director
ALBERT SHANKER, Treasurer

TESTIMONY
OF THE
PUBLIC EMPLOYEE DEPARTMENT, AFL-CIO
COMMITTEE ON FINANCE
SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

MARCH 29, 1982

Mr. Chairman, my name is John J. Sweeney, and I serve as the President of the Service Employees International Union and Executive Vice President of the Public Employee Department, AFL-CIO, which is composed of 34 national unions representing in excess of two million workers at every level of American government. I am pleased to have this opportunity to appear before the committee today to provide you with the Department's views on S. 2105 and S. 2106.

Mr. Chairman, we would first like to commend you for your efforts in introducing the Public Employee Retirement Income Security Act legislation. We at the PED welcome your concern and the leadership you have provided to us this year in taking a meaningful step toward protecting the retirement benefits of public workers.

The PED believes that the regulation, administration, and financial security of public pension funds is a national concern. Today there are over 6,600 separately administered state and local government retirement plans, with total membership exceeding 11 million workers and retirees. The assets of these funds are currently valued at over $200 billion and are expected to increase to one trillion within the next 15 years. The administration and the investment of that much money will necessarily exert a major influence on the structure and performance of the United States economy. For this reason, federal action is required and justified to resolve the serious deficiencies which are prevalent among government pensions as they exist today.

REPORTING AND DISCLOSURE

Public workers have a fundamental right to know about their retirement systems but are often kept in the dark. In a 1981 report, the Urban Institute found reporting and disclosure from most state and local government plans to be inadequate. As many as 40 percent of state and local governments do not automatically furnish their plan participants with plan descriptions. Eighteen percent do not even provide this information on request. Although many government jurisdictions do have some reporting and disclosure laws, the regulations are sporadic and noncomprehensive. What information is supplied by these government plans, is either too brief or too detailed to be of any practical use to the average plan participant or beneficiary. Every day more of our members are faced with the painful reality that the job security which was once found in public service is being threatened by economic and fiscal distress and antigovernment attitudes. Our workers will be relying more and more on what they have been setting aside for retirement as a last chance to achieve income security. PERISA would mandate that the participants be automatically furnished with copies of their plans and other important information that would help them plan for the future. Widespread public disclosure is necessary to curb the potential for administrative abuse, abuse which victimizes plan participants and the taxpaying public. A widely cited study of the asset-management practices of state and local pension funds has documented the extent to which conflicts of interest exist in public employee pension plans. Unfortunately, large segments of the assets held by pension funds are managed in the interest of those who control the funds rather than in the interest of those for whom the funds are intended to provide benefits.

FIDUCIARY RESPONSIBILITIES

The PED strongly supports the regulation of fiduciary responsibilities. The lack of proper oversight can result in investment practices which yield poor returns or which support ventures operating contrary to the beneficiaries' best interest. During the period from 1971 to 1980, the median annual rate of return on total public retirement funds was 5.8 percent; and 1981 the annual median return was only 3.3 percent. These figures are according to A.G. Becker, Incorporated, a leader of fund-investment performance measures. We are not suggesting that the return rate is a direct indication of the lack of proper fiduciary management, but such a low rate of return during a 10-year period of substantially high inflation would make one question the investing practices. We support the general provisions contained in both S. 2105 and S. 2106. However, we strongly prefer, and would suggest that the committee adopt, S. 2106. This is particularly true in the area of requirements and prohibitions relating to fiduciary functions. It is apparent to us that these requirements are much stronger in S. 2106 than in S. 2105. Not only are fiduciaries prohibited from using plan funds for their own personal interest and gain, but they are also prohibited from any sales, lending, or servicing transactions that would be inconsistent with proposed requirements that fiduciaries act in a prudent manner. We cannot allow our members' retirement funds to be used in any way that would not benefit them to the fullest.

ADVISORY COUNCIL ON GOVERNMENTAL PLANS

The PED supports the establishment of an advisory council on governmental plans as a means toward establishing minimum benefit guidelines for government-service retiree plans. The public, it appears, is under the gross misconception that public employees make out like bandits when the time comes for them to draw a pension. The following facts, may correct that perception. First, the average monthly benefit for state and local government employees was only $298.00 in fiscal year 1976-1977, when the most recent calculation of this kind was released. This compares to a poverty-threshold level for a retired couple of $296.00 per month for the same time period. Secondly, more recent figures from the Census Bureau reveal that many pension plans offered monthly benefit payments which were less than $200 -- and even less than $100 -- in fiscal year 1980. Third, the President's Commission on Pension Policy reported that in 1978, the average annual benefit paid from a public pension plan was $4,957 for married couples. These meager income statistics do not even take into consideration the fact that over 90 percent of public pension plans are contributory, compared to only 10 percent of private sector plans. The establishment of an advisory council, we hope, will serve to bring about some standards in the area of benefit structure.

EMPLOYMENT BENEFIT ADMINISTRATION

The Department is opposed to the establishment of an employee benefit administration as provided for in S. 2105. We would prefer the provisions as provided in S. 2106, which give the Secretary of Labor the authority to promulgate and administer regulations to govern the administration of the Act. Although we recognize that it is important that PERISA be governed with expertise and specialization, we suspect that the establishment of a separate agency such as the EBA would do damage to PERISA, especially in its early stages of development. If a single pension agency is established, it is essential that the administration of public plans be handled in a separate manner by those with specialized expertise in the area by placing PERISA, ERISA as certain IRS functions under one control. We fear that there may be an attempt to apply some nonapplicable provisions of one to the other. PERISA will be a separate law in itself and should be governed as such.

In closing, Mr. Chairman, let me reiterate the labor movement's long-standing commitment to an acting Public Employee Retirement Income Security Act. The Public Employee Department affiliated unions voted in favor of a recent convention resolution of the AFL-CIO to make the enactment of PERISA one of the highest legislative goals of the 1980s. We are committed to that end and stand ready to assist you in the effort to seek early approval of this legislation. We will attempt to answer any questions that you may have at this point. Again, thank you.

Senator CHAFEE. Mr. Masten.

STATEMENT OF GEORGE MASTEN, EXECUTIVE DIRECTOR, AMERICAN FEDERATION OF STATE, COUNTY & MUNICIPAL EMPLOYEES, COUNCIL 28, ACCOMPANIED BY CHARLES M. LOVELESS, AFSCME DEPARTMENT OF POLITICAL AND LEGISLATIVE AFFAIRS

Mr. MASTEN. Thank you, Mr. Chairman. I appreciate the opportunity to appear here before you to day to present the views of the American Federation of State, County & Municipal Employees on PERISA bills which you are now considering. I am George Masten, international vice president and AFSCME executive director for Council 28, the State of Washington. I am accompanied by Charles M. Loveless of AFSCME legislation political affairs department.

With your permission, I would ask that our written statement be included in the record.

Senator CHAFEE. We will do that, plus your attachment—well, that makes it a little long. The attachment will be available for anybody who wants it. Why do you not proceed to summarize your statement?

Mr. MASTEN. I also want to express President McEntee's regret that he was unable to be here in person today.

If you want me to summarize, I will be less than my time.

Senator CHAFEE. That is unheard of. [Laughter.]

Mr. MASTEN. We commend you and other members of the subcommittee for holding these hearings because they focus on a serious and troublesome problem.

The exhaustive report of the House Education and Labor Committee's Task Force on Public Pension Plans, the report by General Accounting Office, and the reports of numerous other Federal Government and private studies all underscore one essential fact: our State and local public employee retirement systems face a major crisis.

More than the fiscal stability of these plans is at stake. The problems afflicting these plans threaten as well the many people who depend upon them for their current or future economic security. As you are well aware, the problems are of such magnitude that they threaten the basic fiscal integrity of State and local governments.

From our studies of these many reports, we believe that certain conclusions are inescapable. Many public pension systems are dangerously underfunded. There is no comprehensive and uniform set of legal principles that adequately safeguard the operation of State and local plans.

Fiduciary protections are most often inadequate. Meaningful standards for reporting and disclosure are notable by their absence. Until this time, the Federal Government has done little to protect the millions of participants who are affected.

Mr. Chairman, I want to point out that unlike our brothers and sisters in the private sector who are protected by ERISA, State and local government workers have virtually no Federal protection for their retirement income.

It seems to me a commonsense proposition that the assets of any pension plan belong to its participants, that the assets should be invested for the exclusive benefit of the plan's participants and beneficiaries, and that individuals who control those assets should be held under law to a high standard of behavior.

In fact, all of this is the case in the private sector. Unfortunately, it is by no means a settled proposition in the public sector. Conflicting and ambiguous State and local laws and court decisions have created much uncertainty about the legal rights of the participants and public pension plans.

As a constructive means of addressing the public pension crisis, the union I represent strongly supports the enactment of S. 2106, the Public Employee Retirement Income Security Act of 1982.

This legislation prescribes minimum Federal reporting, disclosure, subfiduciary standards for State and local government pension plans. Our written statement discussed at some length why we prefer S. 2106 to the alternative version of PERISA, S. 2105.

In our view, S. 2106 does not constitute a radical approach to resolving the fundamental problems that threaten State and local government pension plans. S. 2106 carefully limits the degree of Federal intrusion into State and local affairs by giving the States responsibility for administration and enforcement of certain PERISA provisions. It does not constitute, nor should it constitute, a wholesale extension of ERISA to public plans. Instead, it recognizes the unique characteristics of such plans.

We also want to emphasize that the pending legislation does not mandate the existence of a State or local plan. Neither does it mandate the level of benefits to be provided. What it does is attempt to provide some practical assurance that the benefits promised under a voluntary adopted plan are in fact secure.

We believe S. 2106, a bill which clearly is in the interest not only of the participants and the beneficiaries but also the public at large because that public has every right to know how well State and local government pension plan assets are being managed.

In essence, Mr. Chairman, all that AFSCME has asked is a simple right to know, a simple right to know that public employee pension plans are being operated openly and honestly and a simple right to know that public employee pension plans are being well managed and operated without fiduciary abuse.

The millions of State and local government workers and retirees who are counting on these plans for their retirement income deserve no less.

Thank you for the opportunity to express our concerns on this issue, which is a major legislative priority of our union. We would be pleased to answer questions.

[The statement of Mr. Masten follows:]

STATEMENT BY

AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL

EMPLOYEES, AFL-CIO

BEFORE THE

FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

S. 2106

THE PUBLIC EMPLOYEE RETIREMENT INCOME

SECURITY ACT OF 1982

MARCH 29, 1982

Mr. Chairman and distinguised member of the Subcommittee on Savings, Pensions and Investment Policy, I am George Masten, International Vice President of the American Federation of State, County and Municipal Employees (AFSCME), AFL-CIO and Executive Director of Council 28, State of Washington. I am accompanied by Charles M. Loveless of AFSCME's Department of Political and Legislative Affairs. We are here representing the more than one million members of AFSCME who work in state and local governments across the nation.

We are pleased to appear before your Subcommittee today to present our views on S. 2106, the Public Employee Retirement Income Security Act of 1982 (PERISA), introduced on February 13 by Senator John Chafee, which proposes the establishment of reporting, disclosure and fiduciary responsibility requirements and administrative and enforcement procedures for state and local government pension plans.

AFSCME believes that S. 2106 is a prudent and carefully drafted response to the crisis currently facing public pension plans and their participants. State and local government pension plans 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 for insuring that minimum reporting, disclosure and fiduciary standards are met by state and local government retirement systems. As noted in the exhaustive Pension Task Force Report on Public Employee Retirement Systems, issued in May 1978 by the House Committee on Education and Labor (Pension Task Force), public employee pension plans with combined assets conservatively valued at over $200 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 and of the recently released final report of the President's Commission on Pension Policy 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 and of reporting and disclosure such as proposed in S. 2106 is necessary in order to protect plan participants and the public from the wasting of plan assets and plan mismanagement. We set forth below, in greater detail, our reasons for supporting S. 2106 and our views concerning some of the major problems facing state and local government pension plans.

I. <u>CURRENT REPORTING AND DISCLOSURE PRACTICES OF STATE AND LOCAL PLANS ARE TOTALLY INADEQUATE</u>.

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 discribing 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 plans'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 strengths and weaknesses of their retirement systems.

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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.

Two recent studies by public pension experts cooroborate 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 deficiences (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;
- 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 year by the Urban Institute on 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]

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2 Coopers and Lybrand, Financial Disclosure Practices of the American Cities III: Managing Pension Costs (New York: Coopers and Lybrand, 1979), p.6

3 The Urban Institute, The Future of State and Local Pensions (1981).

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:

> 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 fund 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.

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4 Ibid., pp. 16-17

5 Louis M. Kohlmeier, (Twentieth Century Fund 1976), pp. 9-10, Conflicts of Interest: State and Local Pension Fund Asset Management.

II. EXISTING FIDUCIARY PROTECTIONS FOR PUBLIC PLAN PARTICIPANTS ARE INADEQUATE.

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 fiduciaries, the Pension Task Force Report found that state and local control over the management of plan assets frequently has been inadequate as are the existing legal protections for public plan participants. 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 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.

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

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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.

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 recent update of Appendix 5 of the Pension Task Force Report, prepared by the Congressional Research Service, which reviews current legal restrictions on the activities of public plan fiduciaries confirms the fact that there has not been a "recent upsurge in reform activity."[7]

III. CURRENT FEDERAL-STATE REGULATION OF STATE AND LOCAL PLANS IS WHOLLY INADEQUATE TO PROTECT THE INTERESTS OF PUBLIC PLAN PARTICIPANTS.

In their article, "How Much Federal Regulation do Public Plans Need,"[8] set forth below as Attachment A, Michael Leibig

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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).

8 Michael T. Leibig and Robert W. Kalman, "How Much Federal Regulation do Public Plans Need," Pension World, August 1978, p. 22.

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 participant 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 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.

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

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9 Ibid., pp. 24-25

State and Local Pensions: Benign Neglect or Negligence?",[10] 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 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. In this regard, Robert Tilove noted:

> 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

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10 Michael T. Leibig and Robert W. Kalman, "Federal Policies Toward State and Local Pensions: Benign Neglect or Negligence," Employee Benefits Journal, Fall 1978, p. 16.

> 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.[11]

The Internal Revenue Service's lack of enforcement of the non-discrimination and other plan qualification requirements can 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.

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11 Robert Tilove, Public Employee Pension Funds (New York: Columbia University Press), p. 248F.

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. S. 2106 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.

S. 2106 must be enacted to regulate the operation of state and local government retirement systems. This legislation which we believe recognizes the unique problems and characteristics of public pension plans is necessary in order to effectively deal with the major national problems enumerated above. It should be emphasized that the current PERISA bill does not mandate the existence of a state or local pension plan or the level of benefits to be provided. Instead, it merely seeks 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, S. 2106 not only services as an effective federal response to the public pension crisis but minimizes the degree of federal government intrusion in state and local government affairs. This measure 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. This will insure that the scope of federal regulation is kept to a minimum and avoid unnecessary duplication of paperwork.

While AFSCME supports granting state governments authority for enforcing certain provisions of PERISA _if_ their laws are substantially equivalent to the requirements of PERISA, we oppose a provision contained in an alternative version of PERISA - S. 2105 - allowing individual governors to certify that state laws meet minimum federal standards. We are concerned that delegating to individual governors the authority to certify that state laws are substantially equivalent to PERISA will dilute the effectiveness of PERISA. As a practical enforcement point, it is highly unlikely that any governor would not find the laws of his state in accordance with PERISA. In our view, the responsibility of determining whether state laws are substantially equivalent to federal law is most appropriately lodged in the Secretary of Labor, as proposed in S. 2106.

State and local plan compliance with a uniform federal reporting and disclosure standard, as set forth in S. 2106, is urgently needed 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, the reporting and disclosure practices of most state and local plans fall woefully short of the standards established for private plans under ERISA. State and local plans must be required to provide a meaningful, yet understandable, explanation of the rights and responsibilities of plan participants and beneficiaries. Plan participants have an interest only in the disclosure of information regarding the specific provisions of the plans which cover them but also in information as to the strengths and weaknesses of their retirement systems.

A uniform federal standard of fiduciary conduct should be mandated for state and local public employee retirement systems. We concur with the position taken in S. 2106 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 fiduciary standard contained in S. 2106 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.

AFSCME opposes any dilution of the trust and fiduciary protections set forth in S. 2106. We specifically are troubled by the fact that S. 2105 does not appear to impose any explicit legal duty on a fiduciary who allocates all of his or her duties to other fiduciaries. As long as the allocation itself is "prudent", S. 2105 apparently would allow a fiduciary to escape liability even if the fiduciary knew or should reasonably have known that the actions of the cofiduciary violated the law. In our view, this prudence standard would create a great potential for abuse in cofiduciary situations.

We support S. 2106's specific prohibition against certain types of transactions between plan fiduciaries and parties-in-interest if the transaction fails to meet an "arms length" adequate consideration test. As recognized in ERISA, certain potential plan transactions inherently create a great potential for abuse and therefore should be subjected to special scrutiny. Unfortunately, under S. 2105, there are no "per se" prohibited transactions; only self-dealing by fiduciaries would be prohibited.

AFSCME also supports S. 2106's 5% limitation with respect to plan acquisition of employer securities, other obligations and real property. We prefer the 5% limitation, rather than the 10% limitation set forth in S. 2105, because of the particular fiduciary problems raised by public plan investment in securities issued by state and local governments.

We believe that enactment of S. 2106 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). 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 staes 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's discussion of the case, federal reporting, disclosure and fuduciary standards 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.[12]

CONCLUSION

AFSCME believes that the enactment of S. 2106 will not only serve to protect the rights of public participants and beneficiaries but also will protect a plan compelling public interest as well. 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.

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12 See the Pension Task Force's discussion of Usery, Pension Task Force Report, pp. 17-22.

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Senator CHAFEE. Well, thank you very much, Mr. Masten. I have met with Mr. McEntee. Of course, Chuck Loveless has been a big help to us in all of this. I think your union has taken the lead in concern for this. Others are, of course, active, but certainly AFSCME is extremely active. I want to express my appreciation to you, Chuck, Mr. McEntee, and others.

Mr. MASTEN. Thank you, Mr. Chairman.

Senator CHAFEE. Ms. Linda Tarr-Whelan of the NEA.

STATEMENT OF LINDA TARR-WHELAN, DIRECTOR OF GOVERNMENT RELATIONS, NATIONAL EDUCATION ASSOCIATION, ACCOMPANIED BY BYRON SPICE, RETIREMENT SPECIALIST

Ms. TARR-WHELAN. Good morning. I am Linda Tarr-Whelan, director of government relations for the National Education Association. Accompanying me is Byron Spice, retirement specialist for our organization.

The National Education Association is an organization representing over 1.7 million members who work in public education. We appreciate this opportunity to present our views as they relate to S. 2105 and S. 2106, and commend the work of this subcommittee in laying clear alternatives before the Congress on key public retirement issues.

Mr. Chairman, I would request that our statement be entered into the record, and I will summarize that statement for you.

Senator CHAFEE. Yes; we will do that.

Ms. TARR-WHELAN. Our major concern is the security of pension benefits earned by members since they are part of the wages earned over a professional career in the classroom. In the eyes of teachers, a retirement plan is deferred payment for services rendered, a condition of employment, no more, no less. Teachers want what every other American worker wants: a secure and happy retirement. They expect their retirement systems to be secure, and adequately funded, and they expect benefits promised to be paid in full.

Teachers want reasonable ownership rights to their plans and an opportunity for options that would make their pension plans portable. Even though there have been improvements in many teacher pension plans, almost one-fifth of all teachers now lose retirement credits. There is even doubt as to the actual property right a teacher has in his or her pension plan.

We are concerned by the lack of standardization of pension terminology and the lack of minimum disclosure standards of public pension provisions. Those two things make it almost impossible to establish a degree of equivalency between two retirement systems.

Frequently, we find basic information is not available on plans, making the transfer of pension credits across State lines or even within States difficult. Therefore, we welcome the thoughtful set of definitions and reporting, disclosure, and fiduciary responsibility standards which are the bases of both S. 2105 and S. 2106.

At a time of financial distress at the State government level, we are particularly concerned about protecting the health and solvency of our members' pension funds. Public employee pensions are particularly vulnerable to underfunding or underperformance in investment. And frequently, the disastrous results of this are not felt by our members until they are ready to retire in 10 to 20 years.

Most noticeable effect of underfunding and the underperformance is the growing unfunded liability of public employee retirement systems. The unfunded liability of retirement systems to which teachers belong, according to 1979 statistics, is $70 billion. This is the situation with the present laws which govern the amounts and types of investments which administrators of public employee retirement systems can make.

We find that there is a strong and persistent effort to liberalize the State laws governing the investment of public employee retirement assets. We fear that as archaic State statutes are changed, retirement systems will be barraged by every conceivable type of investment package.

Teachers believe that an investment package which is not considered worthy by a banker should not be considered as worthy for State public employee pension funds. We believe that if the prudent person rule is adopted by different States, it will be a different prudent person rule in a State unless there are minimum standards.

There is clearly a need for Federal law to set standards for investment of public pension moneys. Earnings on investment represent approximately 36 percent of the income of retirement systems to which teachers belong.

The NEA is concerned about the status of retirement benefits. They are an earned property right and not the result of public benevolence. They are wages earned which must be paid. In eight States they are considered merely a gratuity, and only eight States guarantee under the Constitution the systems which cover our teachers.

It is a contributory system for most teachers, as well. Ninety-five percent of the participants contribute to the system with the percentage as much as 8 percent in some States.

In conclusion, the NEA strongly supports the efforts of this committee in providing the clear statement of pension definitions, minimum reporting, disclosure, and fiduciary standards, and a mechanism by which States meeting the minimum standards can be exempt from Federal oversight.

The NEA still maintains that public pensions are inherently different from those in the private sector and should not be regulated or administered through a common body such as the Employee Benefit Administration proposed in title II of S. 2105.

NEA prefers the simpler, less burdensome administration by the Secretary of Labor. Principally for this reason, NEA supports S. 2106.

Senator, we wish to express our appreciation to you personally and to this subcommittee for its deliberations on an important matter to the National Education Association.

[The statement of Ms. Tarr-Whelan follows:]

STATEMENT

OF

THE NATIONAL EDUCATION ASSOCIATION

ON

S. 2105 AND S. 2106

BEFORE THE

THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

COMMITTEE ON FINANCE

UNITED STATES SENATE

MARCH 29, 1982

I am Linda Tarr-Whelan, Director of Government Relations for the National Education Association. Accompanying me is Byron Spice, Retirement Specialist. The National Education Association is an organization representing over 1.7 million members who work in public education. We appreciate the opportunity to present our views as they relate to S. 2105 and S. 2106 and commend the work of this subcommittee in laying clear alternatives before the Congress on key public retirement issues.

Our major concern is the security of pension benefits earned by members since they are part of the wages earned over a professional career in the classroom. In the eyes of teachers, a retirement plan is deferred payment for services rendered -- a condition of employment -- no more, no less.

Teachers want what every other American worker wants -- a secure and happy retirement. They expect their retirement systems to be secure and adequately funded, and they expect benefits promised to be paid in full. Teachers want reasonable ownership rights to their plans and an opportunity for options that would make their pension plans portable. Even though there have been improvements in many teacher pension plans, almost one-fifth of all teachers have lost retirement credits. There is even doubt as to the actual property right a teacher has in his or her pension plan. We are concerned by the lack of standardization of pension terminology, and the lack of minimum disclosure standards of public pension provisions which make it nearly impossible to establish any degree of equivalency between two retirement systems. Frequently basic information is not available on plans, making the transfer of pension credits across state lines, or even within states to be a difficult task. NEA therefore welcomes the thoughtful set of definitions and reporting, disclosure, and fiduciary responsibility standards which are the basis of S. 2105 and S. 2106.

IMPORTANCE OF MINIMUM STANDARDS

At a time of financial distress at the state government level we are deeply concerned about protecting the health and solvency of our members pension funds. In times past the assets of pension funds have been managed by political leaders in a way which helped solve budget problems but jeopardized investments on behalf of retirees. Minimum fiduciary responsibilities appeared lacking. Attached is a chart showing the squeeze on state government finance this year before the impact of 1982 federal budget cuts. Recent data shows states are heading into a financial squeeze and public employee pensions must be protected.

For over a decade, various actions have been taken by state governments to reduce the state contribution to their retirement funds contributing to the financial difficulties of the retirement system and transferring a pension obligation of this generation to the next generation.

For example, in 1971, the California legislature appropriated $97 million to the State Teacher Retirement System. Governor Ronald Reagan, in order to balance the budget, reduced the appropriation to $20 million, putting in jeopardy retirement checks of 43,000 retired teachers and forcing the STRS board to make up the difference from its contingency fund which at that time was largely composed of teacher contributions.

Various other problems of prudent management have arisen. Money has either been withheld from the pension fund or payments delayed causing a loss of investment income for the system. The governor and/or legislature has refused to fund the retirement system at the level recommended by the actuary.

In the 1973-75 recession, and whenever finances are squeezed, state administrations ~~receive~~ extreme pressure from business, real estate, and mortgage banking interests to make pension assets available for bond purchases to aid local development, or to provide financial assistance to troubled cities. The NEA is concerned that such investments may be made at a lower yield than could be obtained on the open market or would not meet a prudent person standard. Earnings on investment represent approximately 36 percent of the income of the major public employee retirement systems and therefore earmarking of pension funds for goals other than the protection of assets and earning of the greatest yield, are of genuine concern.

OWNERSHIP OF BENEFITS

The desire by public employees to have a property right in their retirement systems is not a whim. The Pension Task Force Report cited examples where state courts have denied complaints by public employees against retirement systems because these plans were considered a "mere gratuity." Our survey of 40 states shows that retirement benefits in eight states are considered a gratuity. Benefits in 24 are guaranteed by state statutes and only 8 states have a constitutional guarantee of benefits (Alaska, Illinois, Hawaii, Maryland, Michigan, New York, North Carolina, and Washington).

The NEA is concerned that teachers who have worked in the classroom receive retirement benefits which are clearly part of earned wages. Public school teachers are members of either a state or a city retirement system as a condition of employment from their first day in the classroom. In all but three of these systems covering 95% of participants, a percentage of each paycheck (as much as 8 percent) is deducted as a member contribution to the retirement system.

In addition a portion of their wages is paid to the retirement system either by the state or by the school board to provide a retirement income when teachers reach retirement age. According to the Bureau of Census, income to major public employee retirement systems come from the following sources:

Employer contribution	50%
Earnings on investment	36%
Employee contribution	14%

Last year, an estimated 225,000 teachers withdrew their contributions from their pension funds because they had left teaching employment in their state. They could not withdraw their portion of the earnings on investment and the corresponding employee contribution. Indeed, in the 45 states from which we have recent data, the retirement system benefited by over $700 million in unrefunded employer contributions.

The problems of pension portability due to crossing state lines has been a long term concern of the NEA. In 1946, after the last state established a teacher retirement system, the NEA and the National Council on Teacher Retirement turned their attention to developing a system of reciprocity of pension credits between states.

This 15 year effort resulted in the enactment in many states of provisions which permit deferred retirement allowances and the purchase of out-of-state credit but barriers to reciprocity of pension credits remain. Two of these barriers have been alluded to -- the lack of standardization of pension terminology, and generally accepted minimum standards. The basic thrust of S. 2105 and S. 2106 will significantly aid these efforts.

The length of time for vesting in many states remains a problem. The average requirement of the plans NEA surveyed in 1980 is 9 years service regardless of age and 8 years service at an average age of 56. Teacher plans have made some progress because 23 plans vest in five years or less.

NEA strongly urges that the minimum standards include vesting at no longer than 5 years and that portability options be explored.

NEA POLICY

NEA policy is made by the Representative Assembly of approximately 7,000 delegates. Annually since 1976 they have discussed and reaffirmed the NEA position on retirement issues. (See Resolution E-9 "Teacher Retirement" and E-33 "Protection of Retirement System Assets and Earned Benefits" as attached). Important issues which relate to the deliberations regarding S. 2105 and S. 2106 are:

"E-9 Teacher Retirement

The National Education Association shall provide leadership in teacher retirement and believes that state and local retirement systems and programs should include -- . . .

b. Actuarial and investment policies that produce sound financing.

c. Annual independent review and audit.

d. Immediate and full vesting after not more than five years of service.

e. Provisions permitting the purchase of teaching credit earned while a member of another retirement system and credit for leaves for maternity/paternity, including adoption. . .

j. Full funding and equitable administration in the granting of teacher retirement credit for military service, or provision for purchasing up to five years of retirement credit for military service.. .

s. Annual financial statement distributed to all members. . ."

"E-33 Protection of Retirement System Assets and Earned Benefits. . .

The Association is aware of incursions on retirement system assets by state and municipal governments. Such incursions involve either a misuse of assets or the failure to appropriate required funds to the system. Both practices result in increasing accrued liabilities, which reduces the financial soundness of the system and jeopardizes the security of teacher retirement benefits. The Association believes that these incursions on retirement systems can best be prevented by the passage of preventive federal and/or state legislation.

The Association also believes that a retirement system should be exempt from federal regulations when its plan is in compliance with minimal standards prescribed by federal and state statutes. (76,81)"

CONCLUSION

The National Education Association strongly supports the efforts of this Committee and particularly Chairman Chafee in providing a clear statement of pension definitions, minimum reporting, disclosure and fiduciary standards, and a mechanism for states which meet minimum standards to be exempt from federal oversight.

There is however a fundamental difference between S. 2105 and S. 2106 and that is the organizational structure. Since the first discussions of ERISA, NEA has maintained that public and private pensions are inherently different and should not be regulated or administered through a common body such as the Employee Benefit Administration (Title II of 2105). NEA clearly prefers the simpler, less burdensome and more efficient administration by the Secretary of Labor. For this major structural reason NEA supports S. 2106 .

We thank you for the opportunity to testify today on this issue of importance to NEA members.

CAN THE STATES PICK UP THE FINANCIAL SLACK?

Key Facts that Figure in the Future: State Surpluses/Deficits, Tax and/or Expenditure Limits, Tax Structures, and Tax Efforts.

	STATE SURPLUS/DEFICIT (millions)						TAX and/or EXPENDITURE LIMITS								
	Current Receipts/ Expenditures			Total Resources/ Expenditures				Local			St. Income Tax Linked to Fed. Tax	No Broad-Based St. Income Tax	No General Sales Tax	Tax Effort Index	Over or Under (−) Utilization (thousands)
	FY 80	FY 81	FY 82	FY 80	FY 81	FY 82	State	Assmnt. Increase	Prop. Tax Levy	Rev./Exp. Limit					
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Alabama	2	−14	4	18	0	0								85.8	−361003
Alaska	1335	−1163	−350	2194	1031	681			CM			X	X	154.7	419001
Arizona	77	−171	−93	234	119	23	Const.	CMS	CM	CMS	C			107.9	170037
Arkansas	146	101	26	1	0	0			CMS					81.9	−274408
California	−509	−2142	221	2541	29	0	Const.	CMS		CMS				95.5	−1043178
Colorado	−12	−205	13	261	60	78	Stat.		CM		C			96.0	−111569
Connecticut	2	−35	0	0	−35	0						X		102.8	81419
Delaware	9	−15	0	40	22	18	Const.		C		C		X	95.6	−25043
Florida	−15	−210	−349	654	531	307						X		77.0	−1081213
Georgia	25	−93	−66	159	66	0					C			93.4	−209081
Hawaii	108	7	37	179	107	225	Const.				B			128.7	241306
Idaho	−4	−7	−14	7	0	0	Stat.		CMS		B			90.9	−67303
Illinois	0	−165	0	390	225	225					C			98.8	−130245
Indiana	−133	−168	−54	217	66	17			CMS		C			82.2	−820925
Iowa	70	79	163	28	0	30		CMS		S	C			93.4	−181414
Kansas	−14	−46	1	183	138	138		CM	S		C			86.6	−299422
Kentucky	−84	−56	0	14	0	0					C			83.7	−454185
Louisiana	172	−299	−16	550	251	0	Stat.		CMS		C			85.5	−562445
Maine	−5	−13	−3	19	6	3					C			108.4	64948
Maryland	−26	−108	−106	293	105	0		CM			C			110.1	363599
Massachusetts	−401	−268	−145	44	34	10			CMS		C			141.8	1927034
Michigan	−52	−9	0	0	0	0	Const.		CMS		C			111.6	968029
Minnesota	−153	−85	−212	121	20	−100				CM	C			114.4	537022
Mississippi	−12	22	−73	60	82	9			CMS					96.5	−53017
Missouri	87	−177	6	240	64	99	Const.		CMS		C			82.6	−717057
Montana	12	2	36	42	44	79					C		X	88.3	−92600
Nebraska	154	74	89	116	35	36			CMS		A			98.5	−20433
Nevada	−33	−58	4	66	24	33	Stat.			CM		X		65.4	−353063
New Hampshire	−24	−9	−6	10	0	−7						X	X	77.6	−170241
New Jersey	−103	−99	−260	281	300	30	Stat.		C	MS				117.8	1164487
New Mexico	−69	−150	−167	140	114	96		CMS	CMS		B			97.3	−32530
New York	129	−166	16	11	11	12					C			172.2	9757226
North Carolina	97	−154	−131	285	131	0			CMS					92.5	−303990
North Dakota	−3	19	−42	157	176	126		CMS			B			81.6	−113764
Ohio	−215	−8	−4	142	134	129			CMS		C			84.3	−1480550

CAN THE STATES PICK UP THE FINANCIAL SLACK? (CONTINUED)

	STATE SURPLUS/DEFICIT (millions)						TAX and/or EXPENDITURE LIMITS								
	Current Receipts/ Expenditures			Total Resources, Expenditures				Local			St. Income Tax Linked to Fed. Tax	No Broad-Based St. Income Tax	No General Sales Tax	Tax Effort Index	Over or Under (-) Utilization (thousands)
	FY 80	FY 81	FY 82	FY 80	FY 81	FY 82	State	Assmt. Increase	Prop. Tax Levy	Rev./Exp. Limit					
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Oklahoma	78	31	0	56	56	56					B			72.3	—799324
Oregon	—175	—87	—3	36	10	7	Stat.	CMS	CMS		B		X	93.8	—145130
Pennsylvania	—17	—72	—65	68	66	1								104.7	448740
Rhode Island	—15	—61	—35	35	33	1	Stat.				A			123.2	158447
South Carolina	39	—48	0	49	0	0	Stat.							92.4	—151952
South Dakota	5	3	—12	16	20	8						X		84.2	—89738
Tennessee	—1	—14	12	84	36	36	Const.					X		87.1	—407459
Texas	—182	—45	—627	439	394	—112	Const.					X		66.5	—4004254
Utah	—8	—4	—1	9	6	0	Stat.				B			97.3	—29761
Vermont	—8	—2	—2	—7	0	0					A			100.6	36015
Virginia	—93	—317	—29	351	37	3					C			88.3	—802539
Washington	—286	—124	—119	125	0	—119	Stat.		CMS	S		X		98.6	—61222
West Virginia	—11	—67	—15	83	16	1					C			76.2	—397722
Wisconsin	—349	—143	—33	73	1	32			CM	S	C			118.9	754098
Wyoming	25	—99	—6	140	81	75						X		85.3	—111538
TOTAL	—480	—6868	—2319	11314	4726	2293	18	6	19	11	32	10	5	100.0	—

NOTES

Columns 1-6. *Source:* National Governors' Association, National Association of State Budget Officers. *Fiscal Survey of the States 1980-81*. Washington, D.C.: October 1981.

Columns 1-3. These figures show the actual ending balance for General Fund budget transactions on a current income-expenditure basis for FY 80 and estimates of the outcome for FY 81 and 82. Estimates for FY 81 and 82 do not reflect the impact of recent federal tax and expenditure reductions.

Columns 4-6. These figures show actual and estimated General Fund balances taking into account carry-over from prior years and transfers. They do not include estimates of federal tax and expenditure reductions. Negative balances for FY 81 and 82 may be the result of using unrevised revenue or expenditure estimates.

Columns 7-10. *Source:* Advisory Commission on Intergovernmental Relations. Unpublished data. Washington, D.C.: June 1981.

Column 7. This column lists those state governments that currently operate under tax and/or expenditure limitations.
Key: Const. = Constitutional limitation.
Stat. = Statutory limitation.

Columns 8-10. These columns show state imposed limits on local government tax and expenditure powers in three major areas: property assessment increases; property tax levy; revenue and/or expenditure increases. Not shown are property tax rate limits.
Key: C = County
M = Municipal
S = School District

Column 11. *Source:* Advisory Commission on Intergovernmental Relations. Significant Features of Fiscal Federalism, 1979-80 Edition. Washington, D.C.: October 1980. This column indicates the extent to which state personal income tax structures conform to the federal income tax.
Key: A = Virtually Complete Conformance. State tax liability is computed as a percent of the federal liability.
B = Substantial Conformance. State taxable income is defined by reference to the Internal Revenue Code.
C = Moderate Conformance. State adjusted gross income is defined by reference to the Internal Revenue Code.

Columns 12-13. *Source:* Advisory Commission on Intergovernmental Relations. *Significant Features of Fiscal Federalism*, 1979-80 Edition. Washington, D.C.: October 1980. These columns indicate those states not having a broad-based personal income tax or a general sales tax.

Columns 14-15. *Source:* Advisory Commission on Intergovernmental Relations. Unpublished Preliminary Data. Washington, D.C.: 1981.

Column 14. Tax Effort Index is a measure of the extent to which a state tax system produces revenue in relation to its potential based upon a uniform tax structure for all states. For the nation as a whole the index equals 100.0. Thus a state with an index of 125.0 collects 25 percent more tax revenue relative to its capacity than do states on the average.

Column 15. These figures express the difference between actual tax collections and theoretical tax capacity. A negative number indicates additional tax capacity while a positive number indicates above average tax effort.

E-9. Teacher Retirement

The National Education Association shall provide leadership in teacher retirement and believes that state and local retirement systems and programs should include—

a. Autonomous boards of trustees, the majority of which are elected by and from the membership.

b. Actuarial and investment policies that produce sound financing.

c. Annual independent review and audit.

d. Immediate and full vesting after not more than five years of service.

e. Provisions permitting the purchase of teaching credit earned while a member of another retirement system and credit for leaves for maternity/paternity, including adoption.

f. Normal retirement of at least 50 percent of the highest single year's rate of salary after 20 years of creditable service, where actuarially sound, and with destacking provisions; voluntary retirement under these provisions.

g. Disability retirement for a service-connected disability available to teachers from the first day of employment. Nonservice-connected disability retirement shall be available to teachers after five years of service.

h. Automatic cost-of-living increases to retirees and beneficiaries.

i. A joint federal-state program to provide those who have taught in two or more states, or in the Overseas Dependents School System, or other government schools, with benefits substantially the same as they would receive if they retired after a career in one state. Affiliates' support of state statutes compatible with the proposed federal Mobile Teachers Retirement Assistance Act or any program providing comparable portability coverage and Association assistance in preparing and promoting such legislation.

j. Full funding and equitable administration in the granting of teacher retirement credit for military service, or provision for purchasing up to five years of retirement credit for military service.

k. Nondiscrimination on the basis of sex or marital status.

l. Retirement credit for unused sick leave.

m. All compensation, including extra-duty pay, in computing retirement benefits.

n. Benefits not reduced by other sources of income, including Social Security benefits.

o. Preretirement counseling.

p. Retirement housing facilities for teachers.

q. Teachers' contributions and benefits that are not subject to federal income taxation.

r. Internal Revenue Service rules and regulations which are not discriminatory.

s. Annual financial statement distributed to all members.

t. Tax-sheltered annuity and deferred compensation plans with a broad choice of programs that would be available to all members. (69, 81)

E-33. Protection of Retirement System Assets and Earned Benefits

The National Education Association believes that retirement system assets can be invested in all types of investments. Equal consideration should be given to probable income and probable safety of the capital. All retirement benefits earned by teachers should under the law be payable to such teachers. Every effort should be made to maintain or improve existing retirement benefits. No person participating in a retirement system should be forced to accept any reduction in benefits below those in force at any time during the period of membership. The retirement benefits are earned and, therefore, inviolate.

The Association is aware of incursions on retirement system assets by state and municipal governments. Such incursions involve either a misuse of assets or the failure to appropriate required funds to the system. Both practices result in increasing accrued liabilities, which reduces the financial soundness of the system and jeopardizes the security of teacher retirement benefits. The Association believes that these incursions on retirement systems can best be prevented by the passage of preventive federal and/or state legislation.

The Association also believes that a retirement system should be exempt from federal regulations when its plan is in compliance with minimal standards prescribed by federal and state statutes. (76, 81)

Senator CHAFEE. Well, thank you, Ms. Tarr-Whelan. You know, I would be very nervous that hopes would be raised too high from the passage of this legislation. I would want it clear that this is strictly a reporting bill. We are not going to resolve the funding problem, as you know, in any way. I would hate for hopes to be raised that the Federal Government has now solved the problems of public pension funds. Obviously, we will not.

With the passage of this legislation, we think we will call the public's attention to the problems and thus they will be treated with greater care than perhaps they have been in the past. There will be a greater awareness and more attention will be paid to them by State legislatures and so forth.

But in no way does this represent at total panacea, as I am sure you recognize.

Ms. TARR-WHELAN. We clearly understand that, Senator. In fact, what would be of great assistance to us is the kind of spotlight on this issue so that our State affiliates can work with their State legislatures to improve the situation.

Senator CHAFEE. Fine.

All right, Mr. Schaitberger.

STATEMENT OF HAROLD A. SCHAITBERGER, LEGISLATIVE AND POLITICAL DIRECTOR, INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS, AFL-CIO-CLC

Mr. SCHAITBERGER. Mr. Chairman, we the International Association of Fire Fighters has submitted to you our written statement.

Senator CHAFEE. We will put that into the record, Mr. Schaitberger.

Mr. SCHAITBERGER. Fine; I would like just to make then some general comments, and possibly on a little different tack, in providing our support for many concepts contained in S. 2105 and S. 2106.

The IAFF has been somewhat slow in developing its position of supporting the concept of PERISA over the last several years.

Although we admire and acknowledge that the sponsors of this legislation in both the House and the Senate have the highest caliber of motivations for this legislation, we have been somewhat skeptical and concerned about the motivations of some who support PERISA as a possible vehicle for capping benefits, for trying to reduce the increased cost to local government, and whether or not some view this legislation as a vehicle to ultimately bring this about.

However, after studying the issues thoroughly and after trying to look at what is the standard and not the exception to the rule, our organization has now taken a position to support the concept of minimum standards of reporting and disclosure and fiduciary standards.

We would be remiss not to bring to the committee's attention that there are State plans which are extremely well structured and who maintain very high standards and who are administered quite competently. Just a few of those would be State plans located in the States of Ohio, Colorado, Nevada, and several others.

However, it appears that this is unfortunately the exception to the rule, particularly when taking into account the hundreds of local and municipal plans covering tens of thousands of public employees at that level.

We were also concerned that PERISA not, as you just mentioned, not attempt to handle and to correct the funding standard in one harsh new piece of legislation. Certainly, the fire fighters in this country are concerned about the funding of their plans throughout every system and stand to work toward the full funding of each of those plans.

But the adoption of harsh funding standards we have viewed as the possible demise of benefits or the unnecessary fiscal burdens on State and local governments.

We therefore come to the issue of these two pieces of legislation; and that is, the Federal Government setting minimum standards in the area of reporting and disclosure. It is sad, but it appears a fact, that many public workers throughout this country have absolutely no knowledge what their benefit entitlements are much less what their vested rights are, if they are vested, and what their dependents or survivors would be entitled to. We think this is wrong, and this needs to be corrected.

Additionally, there are unfortunately too many funds whose fiduciaries do not act in a prudent manner and do not understand or are not well versed in the handling of pension funds, assets, portfolios, investments, and the like.

We also see the need for setting up certain prohibited transactions, although we would like to caution the committee and bring to the chairman's attention that there are certain sections within the prohibited transactions areas we would not like to see overdone.

For example, there are those who have determined or who at least view that some of the prohibited transactions in S. 2106 would prevent a lot of the normal administrative relationships between public pension plans and their municipal governments.

My understanding is that it could possibly be construed that a small pension plan who would be located possibly in the building of a local or a municipal government may have to pay rent on that space where now that is given to them free of charge.

Where pension plans possibly utilize the data processing services of a municipal government, or the reverse, a large pension plan who provides data processing services to smaller plans within a jurisdiction, that could be construed as prohibited, since the laws require a fair return for all goods and services and that they pay a fair market for all goods and services received.

We hope that that would not be the interpretation of those areas and that the committee would look closely at that section to ensure that those kinds of relationships would not be affected.

We also would like to add our preference to sections in S. 2106 which would allow the Secretary of Labor the right to determine whether or not a State plan or a municipal plan would be sufficiently equivalent to or greater than the standards that are set forth in the Federal act, and likewise would express our support for the Department of Labor to have overall regulatory authority rather than the establishment of a new Federal agency, the Employee Benefit Administration.

Again, the IAFF supports many provisions in both bills generally in concept and prefer the provisions in S. 2106 for the committee to use as their base. We would stand ready to assist the committee in any way we can toward that end.

[The statement of Mr. Schaitberger follows:]

TESTIMONY

before the

SENATE FINANCE COMMITTEE

on

THE PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT
(PERISA)
S 2105 and S 2106

March 29, 1982

by the

INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS, AFL-CIO-CLC

Mr. Chairman, distinguished Members of the Committee, I am Harold A. Schaitberger, Legislative and Political Director for the International Association of Fire Fighters (IAFF), AFL-CIO-CLC. I am here representing the more than 175,000 professional fire fighters working for Federal, State and local governments across the nation, who make up the membership of the IAFF.

We are pleased to appear before your Committee, to present our views on S 2105 and S 2106, the Public Employee Retirement Income Security Act of 1982, recently introduced by the distinguished Chairman of this Committee, Senator John H. Chafee. Today, we will be directing our comments primarily towards HR 2106.

Although we support, in concept, the general provsions expressed in both bills, S 2106 more closely represents the views and position of our International Union. As you know, this legislation proposes to establish Federal standards for the reporting, disclosure and fiduciary responsibility requirements, as well as for administrative and enforcement procedures, to be adhered to by State and local government pension plans.

The IAFF believes that S 2106 and its companion bill in the House, HR 4929 introduced by Congressman Philip Burton, are prudent and carefully drafted responses to the problems currently facing public pension plans and their participants. We can see that the serious problems facing State and local government plans not only threaten the plans' fiscal stability and the rights of thier participants and beneficiaries; but they also threaten the overall fiscal integrity of State and local governments as well.

No comprehensive or uniform set or regulations and principles currently exist for the adequate regulation and administration of State and local government plans. There are exceptions, of course, and we note that there are several States, for example Ohio, Colorado, and Nevada which have independently established comprehensive reporting, disclosure and fiduciary standards, as well as many of the other protections found in the legislative proposals before you today.

However, the majority of State and local government plans fail to meet the minimum standards proposed in S 2106. There are conflict of interest problems and there is an absence of understanding on the part of plan participants of the entitlements which are being provided by their pension programs. A Federal regulatory framework which recognizes the problems and characteristics along with the needs of State and local plans has yet to be established.

We believe the Federal government has a responsibility for insuring that minimum reporting, disclosure and fiduciary standards are met by State and local government retirement plans. Conservative estimates have recently valued combined plan assets of public employee pension plans at over $200 billion. This huge amount certainly influences political and economic affairs in this nation. We, therefore, concur with the finding of the President's Commission on Pension Policy, that current regulation of State and local plans is generally inadequate, and that Federal legislation should be enacted to protect the vital national interest involved.

In our view, the uniform Federal standards for fiduciary conduct and for reporting and disclosure that are being proposed in S 2106, are necessary in order to protect plan participants and the public from wasteful practices and from the possibility of plan mismanagement. The IAFF feels that the current reporting and disclosure practices of State and local plans are generally inadequate.

In many instances plan participants are not informed of their basic benefit rights through a simple plan booklet; not to mention, being appraised of the financial condition of their plans, or to what degree they may have a vested interest. 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 materials describing plan provisions. Plan participants in approximately 18 percent of the surveyed plans were unable to obtain plan descriptions, even upon request.

We believe 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 operating in accordance with the generally accepted financial and accounting procedures applicable to pension plans in the private sector. A lack of reporting and disclosure requirements leaves many pension plan participants and their beneficiaries without a realistic assessment of their pension benefits and entitlements, or the strenghts and weaknesses of the retirement system under which they are covered.

Furthermore, many of the current financial reporting procedures do not provide sufficient information to allow participants to judget the financial performance of their funds. Many plans do not disclose the current market value of their plan assets, nor do they provide information that would permit the evaluation of investment managers or portfolio managers.

It should be emphasized that the lack of regular systematic reporting and disclosure practices does not only pose a problem for plan participants and beneficiaries. Tax payers and investors,and even government officials, are sometimes kept in the dark regarding the true costs and investment practices of State and local government pension plans.

Another area which we are greatly concerned with is the lack of uniform standards of fiduciary conduct for public plan fiduciaires and trustees. Again, the Pension Task Force Report found that State and local control over the management of plan assets frequently has been inadequate, as are the existing legal protections for public plan participants. Conflicts of interest in management and investment practices and other examples of fiduciary misconduct have occurred due to the absence of a uniform standard of conduct.

I think it is obvious that those who have control of pension plan assets should be held to a high standard of behavior and should face laibilities if they fail to satisfy that standard. Again, there are several States in this nation that do in fact provide for comprehensive and strong fiduciary standards. However, these appear to be the exception to the rule.

We have observed situations where plan fiduciaries have acted primarily in the interest of others, rather than of the plan participants and their beneficiaries. Many times these fiduciaries are directly connected with the governing body, and their decisions may be slatned toward favoring the interests of the State or local government itself. Other fiduciaries and trustees often favor locally oriented service providers and investements, despite the fact that such investments or providers may not work towards the best interests of the plan or its participants.

We also feel that setting fiduciary standards will encourage many plans that do not engage the services of professional investment managers, to do so. Typically, investment professionals are not found on the Boards of public pension plans or among their trustees. 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 those of professionals.

Opponents to this legislation will state their belief that the government should not intervene. and, in fact, will suggest that the Federal government does not have the constitutional authority to provide a Federal standard for the administration and regulation of State and local government pension affairs. The IAFF, however, believes that legislation such as S 2106 not only serves as an effective Federal response to current public pension plan problems, but it also minimizes the degree of Federal government intrusion into State and local government.

The proposal does not mandate the existence of a State or local pension plan, or the level of benefits that must be provided by a State or local government through these plans. Rather, the legislation merely seeks to provide some assurance that benefits promised under a voluntarily adopted plan are paid, and that the plans are operated without discrimination and in a prudent administrative and fiduciary manner.

The measure establishes only minimum standards for reporting and disclosure and for fiduciary conduct. The bill contains specific authorization for State governments to have responsibility for the adminsitration and enforcement of certain provisions. Furthermore, if State law in the areas of reporting, disclosure or bonding and in the area of civil and criminal penalties and the protection of participants' rights, are found to be substantially equivalent to the requirements of the Federal legislation; the State may apply for authority to assume sole responsibility in those area, thus, avoiding all Federal government intrusion. This should help to insure that the scope of the Federal regulation is met, but it will help to avoid any unnecessary duplication of paperwork.

Again, the IAFF supports the concepts contained in S 2106, when it provides that the Secretary of Labor will make such decisions, as opposed to the Governor, as is the case in S 2105. We are concerned that delegating the authority to certify that State law is equivalent to PERISA to individual Governors may dilute the effectiveness of the Act. As a practical matter it is highly unlikely that any Governor would not find the laws of his State in accordance with PERISA.

We believe that enactment of S 2106 is truly necessary in order to protect the vital national interest involved, and that any possible constitutional objections based on the U.S. Supreme Court decision in the National League of Cities vs. Usury case, will be overcome. We note that in that case the Supreme Court declared the application of the mandatory minimum wage and maximum hour provisions of the Fair Labor Standards Act to State and local governments as being unconstitutional under the Commerce Clause. The Court held that imposing these provisions on these governmental entities would "...impermissibly interfere with the integral governmental functions..." of the States in exercising their 10th Amendment rights, and that it would impair their "...ability to function effectively in a Federal system."

Importantly, as emphasized in the Pension Task Force Report discussion of the case, Federal reporting, disclosure and fiduciary standards "...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 costs." Therefore, the proposed standards would not reach the level of Federal intrusion into integral State government functions which the Court found objectionable in Usery.

In conclusion, Mr. Chairman, the International Association of Fire Fighters believes that the enactment of S 2106 will not only serve to protect the rights of public plan participants and their beneficiaries, but it will also protect the public interest as well.

We want to thank the Members of your Committee for this opportunity to present our statement before you, and we look forward to continuing to work with you on this matter of utmost concern to professional fire fighters throughout this nation.

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

Let me see a show of hands here. As you all know, this legislation provides for the States to take over. In other words, the Federal Government is out of this area if the States adopt the requisite legislation. So this is not a case of the Federal Government remaining in the business forever, presumably, and I hope not for long. Show your hands if you think that it is satisfactory for this responsibility to go back to the States if they pass the legislation.

Mr. SWEENEY. Senator, is that without any supervision or enforcement by the Department of Labor?

Senator CHAFEE. Well, there is some supervision.

Mr. MASTEN. They have to meet the fiduciary requirements and so on?

Senator CHAFEE. Yes; but this worry is always expressed. Mr. Sweeney, I think, is suggesting that once the States take over, oversight by the Federal Government probably would be reduced. Just look at how much attention the Federal Government pays to local and State insurance supervision? Precious little.

But the way it has worked out is, at least in the insurance field, the States have been vigilant, for better or for worse. They carry on, and I do not know of any Federal oversight.

So everybody recognizes this scenario is likely; the Federal Government can be out of this oversight responsibility. But I just wonder how strong the oversight should be.

Mr. SWEENEY. Well, I believe that unless there is strong overseeing, that it would be a tremendous failure or the legislation in the long run.

Senator CHAFEE. Well, that is a good point. What do you say to this? The unions have been very strong in requiring what we call social investments by private pension plans. Why does not Morgan Guaranty sink some money into the Bronx? This legislation runs contrary to that social investment concept by implying that the sole criterion must be the welfare of the fund, the highest return for the beneficiary.

How do you reconcile that difference in approach? Would you be prepared to accept it? In other words, New York City no longer would be able to come to the pension funds and get bailed out.

Mr. MASTEN. AFSCME has been involved in the Midwest and different places in support for the social concerns. But the important thing is that in trying to help out in the social area, you also protect the traditional concerns of safety, risk, and rate of return for the plans. We think both can be done. We do not think you can just blindly close your eyes to the return to the plan and the protection of the participants in solving the social problems. You have to look at both, and we think that both can be done.

Senator CHAFEE. But as you know, there have been very stern cries, particularly in the Northeast, as to why these banks and insurance companies, whatever they might be, do not put some of that pension money right back here instead of making investments in shopping centers in Tucson or wherever there is the greatest growth?

So we do have a problem here.

Mr. SCHAITBERGER. Mr. Chairman, I would also like to bring up, though, you mentioned the New York City case, which certainly the pensions came to the aid of the city government, but there are a number of areas of social investment and it seems to me that the act states that the funds should be invested in the best interest and for the purpose of the participants.

If you take an area such as providing mortgages, which has been a question under ERISA for some time, it seems to me that it would certainly be in the best interest of the participants if a pension could, one, provide a mortgage for the participants of that plan at possibly a slight or less than market rate but what would still be a very adequate or good return on their pension assets, and at the same time help to create jobs in their community and such.

So I think there are a number of areas where social investing can in fact serve in many ways to the betterment and in behalf of the participants of the plan.

Senator CHAFEE. Well, there is no question that this language would throw a chill over that technique. No matter how you read the language, it must be in the best interest of the participants.

The language means, as you look at it, the financial interest of the beneficiaries would be of utmost concern.

So when you start giving low-interest loans to reinvigorate the city or the community in some style, I think you run into a pretty difficult problem there.

What the low-interest loans might do is to give an advantage to the younger workers, say, the fire fighters. Suppose these low-interest loans go to build housing for the younger people. This would be to the detriment of the retirees, because the interest is, by definition, low interest. I think everybody ought to recognize this.

Mr. SWEENEY. But if you look at the investment return over the past 10 years, I am sure that these low-interest mortgages that you are referring to would yield higher than the 3-percent investment return.

Senator CHAFEE. Oh, yes, they might, but when you see these low-interest returns, you never know whether they may be locked into long-term bonds that earned 2 percent when they were bought and this return looked very good.

I remember going through a portfolio and seeing some bonds issued by the city of Baltimore with Mayor D'Allesandro's picture on them, oddly enough, 1 percent bonds. I thought he deserved to have his picture on it if he could peddle bonds at 1 percent. [Laughter.]

So you do not know. I must say I was amazed at the statistic you showed that the return was so low.

Well, gentlemen and ladies, thank you very much for your testimony.

Now, the next panel, Mr. Clark, Mr. Natale, and Ms. Kreamer.

Senator Clark, we are delighted to have you here representing the National Conference of State Legislatures.

If everybody will abide by the time, since we went over a little, this panel will go to 11:05.

All right, Senator Clark, we are delighted you are here.

STATEMENT OF HON. JAMES CLARK, SENATOR IN THE MARYLAND STATE SENATE

Mr. CLARK. Thank you, Mr. Chairman. It is a real pleasure to be here. I am also representing the National Governors Association today. Their position is identical to the National Conference of State Legislatures.

The State legislatures and the Governors share the goal of this committee of insuring adequate security for State and local employees in their retirement years. We strongly disagree, however, with the method proposed in the PERISA legislation.

The PERISA legislation is contrary to the notion of federalism and the principle of sorting out the various responsibilities among the various levels of government. At a time when the program responsibilities are being returned to the States and sorting out activities are progressing, this legislation represents a clear preemption of State laws and responsibilities.

The ACRI study, State and Local Pension Systems—Federal Regulatory Issues, specifically focused on this issue and concluded that State and local retirement systems should be exempt from any ERISA-type requirements. The PERISA legislation before you would impose disclosure, reporting, and disclosure, and fiduciary regulations on State and local plans and give substantial regulatory power to a Federal agency.

The legislation would add another level of bureaucracy and increased cost at a time when concerted strides have been made by this Congress and the administration to reduce the regulatory burden on State governments and all our citizens.

In voicing our concern over the proposed PERISA legislation, we do not intend to minimize the problems which still are present in some State retirement plans. State officials have long recognized the need for reform of public systems. The creation of the NCSL pension system is a clear reflection of the interest of State legislators in the pension area.

The work of the pensions committee and the efforts of many State legislators who participated were instrumental in publicizing the need for reform of State plans. The Governors have also had longstanding policy in this area, calling for an appropriate method of reporting and disclosure and adequate funding of benefit costs.

States have a long and successful record of reforming their public plans. In 1975 only four State legislatures had standing legislative committees which dealt with pensions. Now over half of our States do. As recently as 1978 only a dozen States had pension commissions; 29 have either created pension commissions or are in the process of doing so.

In your own State of Rhode Island, Mr. Chairman, a special commission established in 1981, composed of representatives of labor, the municipalities, and the legislature, currently is investigating the topic.

Senator Paul Hannoway was the chairman of our National Legislative Pension Committee, and he preceded me in that spot. He has had a great interest and been a leader nationwide.

States have also taken great strides in their funding methods. In Maryland we are engaged in a continual effort to upgrade our pension system. In 1975, recognizing the need for improvement, we passed legislation establishing a special pension committee to evaluate our plan and to make recommendations to the legislature.

In 1977 we passed legislation establishing fiduciary standards and requiring an actuarial analysis of all pension bills. In 1978 we required annual reporting by local governments. In 1979 we established a new system integrated with social security and based upon a fully funded system.

Finally, Mr. Chairman, I would urge you to closely examine the Federal Government's method of reporting. It is my understanding that this reporting that you are now getting under your statute is based on static assumptions which do not recognize the substantial impact of inflation on pension plans. In our reform of the pension system in Maryland, we require the use of dynamic methods of actuarial accounting which does factor in inflationary cost increases.

There is a large role for the Federal Government to play in strengthening all pension systems, both public and private, and at the same time save our taxpayers billions of dollars.

If the Federal Government is willing to take the steps necessary to stop the inflation that is wreaking havoc with all pension systems, then it will deserve all the accolades and praise our Nation can muster. Inflation is the No. 1 enemy of sound pension policy in America. Bring it under control, and the remaining problems will be easily put right.

We firmly believe that the States have done far more to meet their pension problems than the Federal Government has done to meet its.

The unfunded liabilities of the Federal pension systems as of December 1981—and this is figured on the static method, which is really not up to date—exceed the dollar national debt and are growing at a much faster rate.

It is a mathematical certainty that we will fail financially if a beginning is not made to bring the Federal pension problem under control by this Congress.

The States are far more united in their opposition to PERISA legislation than on any other matter which has before us in many years.

In light of the Supreme Court decision in the case of *National League of Cities* v. *Usery*, which said that you could not fix minimum wages for local governments, we believe that this legislation may clearly be unconstitutional to begin with.

In closing, Mr. Chairman, I would say that the magnitude of the State and local pension systems, the problems that they have are miniscule when compared to the problem of the Federal pension systems. As a Federal taxpayer, I worry very much about you all recognizing and discovering what the size of your problem is and starting to do something about it.

We are 7 years ahead of you in Maryland. We started in 1975. We found out what our problem was, and then we have taken a series of steps to correct it.

[The statement of Mr. Clark follows:]

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STATEMENT OF SENATOR JAMES CLARK

BEFORE THE SENATE COMMITTEE ON FINANCE

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY ON

THE PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT

S. 2105 & S. 2106

MARCH 29, 1982

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. MY NAME IS JAMES CLARK AND I AM PRESIDENT OF THE MARYLAND STATE SENATE. I APPEAR BEFORE YOU TODAY AS CHAIRMAN OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES' (NCSL) COMMITTEE ON PENSIONS AND AS A REPRESENTATIVE OF THE NATIONAL GOVERNORS' ASSOCIATION (NGA), WHICH HAS JOINED WITH NCSL IN PRESENTING THIS STATEMENT. I HAVE ALSO HAD THE PRIVILEDGE OF SERVING ON PRESIDENT CARTER'S COMMISSION ON PENSIONS POLICY WHICH CONDUCTED A 2 YEAR, $2 MILLION STUDY.

NCSL IS THE OFFICIAL BI-PARTISAN REPRESENTATIVE OF THE NATION'S 7500 STATE LEGISLATORS. NGA REPRESENTS THE 55 GOVERNORS OF THE STATES AND TERRITORIES. BOTH GROUPS SEEK TO FOSTER INTERSTATE COOPERATION AND TO ASSURE A STRONG VOICE FOR STATES IN THE FEDERAL DECISION-MAKING PROCESS.

ON BEHALF OF THE NCSL AND NGA, I APPRECIATE THE OPPORTUNITY TO DISCUSS WITH YOU TODAY THE CONCERNS OF THE NATION'S STATE OFFICIALS ON S2105 AND S2106, LEGISLATION TO REGULATE STATE AND LOCAL PUBLIC EMPLOYEE RETIREMENT SYSTEMS.

THE NCSL PENSIONS COMMITTEE, WHICH I CHAIR, HAS BEEN THE FOCAL POINT FOR ACTIVITIES OF THE LEGISLATURES AIMED AT IMPROVING PENSION PLANS IN THE STATES. AS A COMMITTEE, WE HAVE URGED STATE LEGISLATURES TO ESTABLISH SPECIAL JOINT PENSION COMMITTEES TO REVIEW AND MAKE RECOMMENDATIONS FOR REFORMING THEIR INDIVIDUAL RETIREMENT SYSTEMS. AS LEGISLATORS, THE 70 MEMBERS OF THE NCSL PENSIONS COMMITTEE HAVE BEEN IN THE FOREFRONT OF RECOMMENDING

CHANGES IN THEIR STATE SYSTEMS AND ARE RESPONSIBLE FOR MANY OF THE SIGNIFICANT IMPROVEMENTS IN STATE PENSION SYSTEMS OVER THE LAST DECADE.

THE NGA SUBCOMMITTEE ON PUBLIC RETIREMENT SYSTEMS, CHAIRED BY GOVERNOR GEORGE R. ARIYOSHI OF HAWAII, HAS WORKED TO IMPLEMENT THE LONG-STANDING POLICY OF THE GOVERNORS FOR ADEQUATE AND ASSURED BENEFITS FOR PARTICIPANTS IN PUBLIC RETIREMENT SYSTEMS. THE GOVERNORS' POLICY TREATS SUCH AREAS AS REPORTING AND DISCLOSURE, BENEFIT DESIGN, FIDUCIARY DUTIES, FUNDING, VESTING AND PORTABILITY, AND OVERSIGHT OF LOCAL PENSION PLANS.

STATE LEGISLATORS AND GOVERNORS SHARE THE GOAL OF THIS COMMITTEE OF INSURING ADEQUATE SECURITY FOR STATE AND LOCAL EMPLOYEES IN THEIR RETIREMENT YEARS. TO ACHIEVE THIS GOAL, WE HAVE UNDERTAKEN SIGNIFICANT STEPS TO RECTIFY THE SHORTCOMING OF OUR EMPLOYEE RETIREMENT PLANS AND HAVE URGED ALL STATES TO WORK TO IMPROVE THE FUNDING AND MANAGEMENT OF STATE PENSION PLANS.

DESPITE THE SIMILARITY OF PURPOSE BETWEEN STATE LEGISLATORS AND GOVERNORS AND THIS CONGRESSIONAL COMMITTEE, WE MUST DISAGREE WITH THE METHODS PROPOSED IN THE PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY (PERISA) LEGISLATION. REGULATION AND OVERSIGHT OF STATE AND LOCAL PENSION PLANS SHOULD REMAIN WITHIN THE PURVIEW OF EACH INDIVIDUAL STATE. IT IS OUR BELIEF THAT STATE GOVERNMENT IS THE APPROPRIATE LEVEL TO DEAL WITH EMPLOYER-EMPLOYEE RELATIONS IN THE AREA OF GOVERNMENT EMPLOYEE COMPENSATION. S2105 AND S2106,

DESIGNED TO REGULATE STATE PLANS, REPRESENT AN INTRUSION OF THE FEDERAL GOVERNMENT INTO AFFAIRS THAT ARE WITHOUT QUESTION WITHIN THE PROVINCE OF STATE GOVERNMENT. FEDERAL REGULATION IN THIS AREA IS NOT ONLY INAPPROPRIATE BUT ALSO IMPINGES ON THE DIVISION OF POWERS SET FORTH IN THE U.S. CONSTITUTION.

THE ISSUE OF FEDERALISM HAS RECEIVED MUCH ATTENTION OVER THE PAST YEAR. AS ORGANIZATIONS, NCSL AND NGA HAVE LONG SUPPORTED REFORMING OUR FEDERALISM SYSTEM, SUCH THAT POWER IS DISTRIBUTED BETWEEN THE NATIONAL GOVERNMENT AND THE STATES AND THEIR SUBDIVISIONS AND THAT DIFFERENT LEVELS OF GOVERNMENT RETAIN OR ASSUME THOSE FUNCTIONS WHICH ARE MOST APPROPRIATE FOR EACH GOVERNMENTAL UNIT. DURING THE PAST YEAR'S BUDGET DELIBERATION, ADDITIONAL DUTIES AND RESPONSIBLITIES WERE RETURNED TO THE STATES IN ACCORD WITH A NUMBER OF FEDERALISM PRINCIPLES. WHILE BLOCK GRANT AND SIMILAR LEGISLATION REFLECT A BELIEF THAT STATE GOVERNMENT IS BEST EQUIPPED TO MAKE DECISIONS THAT UNIQUELY AFFECT STATE INTERESTS, THE PERISA LEGISLATION IS A STEP AWAY FROM STATE RESPONSIBILITY AND TOWARD FEDERAL PREEMPTION.

AN ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS (ACIR) STUDY EVALUATED THE UNDERLYING QUESTION OF WHICH LEVEL OF GOVERNMENT SHOULD CONTROL PUBLIC PENSION SYSTEMS. BASED ON THIS STUDY, STATE AND LOCAL PENSION SYSTEMS--FEDERAL REGULATORY ISSUES, THE COMMISSION CONCLUDED THAT STATE AND LOCAL RETIREMENT SYSTEMS SHOULD BE EXEMPT FROM ERISA TYPE REQUIREMENTS. THE REPORT EXPRESSED OPPOSITION TO ALL FORMS OF FEDERAL REGULATION OF STATE

AND LOCAL PLANS. THUS, IN SPECIFICALLY FOCUSING ON THE FEDERALISM ISSUE, ACIR DECIDED THE QUESTION IN FAVOR OF STATE CONTROL.

NCSL'S AND NGA'S SUPPORT FOR A REVITALIZED FEDERALISM HAS PROMPTED INVOLVEMENT IN A DIALOGUE WITH THE ADMINISTRATION AND THE CONGRESS ON "SORTING OUT" THE VARIOUS RESPONSIBILITIES FOR PROGRAMS AMONG LEVELS OF GOVERNMENT. AT A TIME WHEN PROGRAM RESPONSIBILITIES ARE BEING RETURNED TO THE STATES AND SORTING OUT ACTIVITIES ARE PROGRESSING, THE PERISA LEGISLATION REPRESENTS A CLEAR PREEMPTION OF STATE LAW AND RESPONSIBLITIES.

THE PERISA LEGISLATION BEFORE YOU WOULD IMPOSE DISCLOSURE, REPORTING AND FIDUCIARY REGULATIONS ON STATE AND LOCAL PENSION PLANS AND GIVE SUBSTANTIAL REGULATORY POWER TO A FEDERAL AGENCY. THE LEGISLATION WOULD ADD ANOTHER LEVEL OF BUREAUCRACY AND ADMINISTRATIVE PAPERWORK AND INCREASE COSTS AT A TIME WHEN CONCERTED STRIDES HAVE BEEN MADE BY THE ADMINISTRATION AND CONGRESS TO REDUCE THE REGULATORY BURDEN ON STATE GOVERNMENT AND ALL OUR CITIZENS.

WHILE THIS LEGISLATION WOULD EXEMPT STATE AND LOCAL PLANS FROM REPORTING AND DISCLOSURE REQUIREMENTS WHEN THESE PLANS HAVE SUBSTANTIAL EQUIVALENCE REQUIREMENTS, IT WOULD IMPOSE FIDUCIARY AND OTHER REGULATIONS EVEN ON SUPERIOR STATE STATUTES. IN RELATION TO THE REPORTING AND DISCLOSURE REQUIREMENT, HOWEVER, WE ARE AWARE OF THE SUBSTANTIAL IMPROVEMENT IN S2105 IN SPECIFYING THAT THE GOVERNOR MAY CERTIFY THAT THE STATE HAS SUBSTANTIALLY

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EQUIVALENT REQUIREMENTS. THIS CHANGE IS A WELCOME IMPROVEMENT.

WE RECOMMEND THAT THE MECHANICS OF THE STATE CERTIFICATION PROCESS BE CLARIFIED SO THAT THE CERTIFICATION IS ACCEPTED UNTIL AND UNLESS IT HAS BEEN ESTABLISHED THAT THE STATE IS ACTUALLY NOT IN COMPLIANCE. THIS SUGGESTION IS MADE IN LIGHT OF A POINT COVERED BY GOVERNOR ARIYOSHI IN PREVIOUS TESTIMONY. HE SAID, "IN OUR EXPERIENCE, FEDERAL AGENCIES FIND IT SO DIFFICULT TO DEFINE SUBSTANTIAL EQUIVALENCE THAT THE ONLY WAY FOR STATE AND LOCAL GOVERNMENTS TO ENSURE THEIR OWN COMPLIANCE IS TO SATISFY THE LETTER OF THE LAW."

THE PROPOSED LEGISLATION, S2105, WOULD ALLOW THE GOVERNOR TO CERTIFY SUBSTANTIAL EQUIVALENCE RATHER THAN THE STATE. NCSL WOULD SUGGEST THAT THE TERM "STATE" BE USED IN PLACE OF "GOVERNOR", THEREBY ALLOWING CERTIFICATION ACCORDING TO STATE LAW, PRACTICE OR CONSTITUTIONAL PROVISION. NGA DOES NOT SUPPORT THIS CHANGE, BUT OUR ORGANIZATIONS ARE BOTH AVAILABLE TO WORK WITH YOU ON THIS MATTER.

THERE IS NO QUESTION THAT THE TYPE OF REGULATION CONTEMPLATED IN PERISA WOULD PLACE SUBSTANTIAL COMPLIANCE COSTS ON THE STATES. RECOGNIZING THE BUDGETARY PROBLEMS AT THE FEDERAL LEVEL, IT SEEMS UNLIKELY THAT THE CONGRESS WOULD PROVIDE FINANCIAL SUPPORT TO ASSIST STATES WITH THESE COSTS. THUS, STATES WOULD HAVE TO APPROPRIATE FUNDS OUT OF THEIR GENERAL REVENUES. AS YOU ARE AWARE, THIS COULD NOT OCCUR AT A WORSE TIME FOR STATES THAT ARE

ATTEMPTING TO COPE WITH REDUCTIONS IN FEDERAL FUNDS AND IN STATE REVENUES DUE TO THE RECESSION. MANY STATES ALSO FACE TAX AND EXPENDITURE LIMITATIONS. IT IS MY BELIEF THAT RATHER THAN FORCING STATES TO USE THEIR LIMITED FUNDS TO COMPLY WITH FEDERAL STANDARDS, THESE RESOURCES SHOULD BE DEVOTED TO MORE WORTHWHILE PURPOSES SUCH AS REDUCING THE UNFUNDED LIABILITIES IN OUR STATE SYSTEMS.

ALTHOUGH THE PROPOSED LEGISLATION WOULD MANDATE NUMEROUS REPORTING REQUIREMENTS, THERE IS NO CONSENSUS ON STANDARDS OF REPORTING AND DISCLOSURE, EVEN AMONG THE COMMUNITY OF FINANCE PROFESSIONALS. THE GENERAL ACCOUNTING OFFICE, THE NATIONAL COUNCIL ON GOVERNMENTAL ACCOUNTING, THE FINANCIAL ACCOUNTING STANDARDS BOARD AND THE MUNICIPAL FINANCE OFFICERS' ASSOCIATION ALL HAVE VARYING CONCEPTS OF WHAT FORM PENSION REPORTING SHOULD TAKE. THE NEWLY PROPOSED GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) MIGHT DEVELOP YET A DIFFERENT UNDERSTANDING. WITHOUT A CLEAR CONSENSUS EVEN AMONG ACCOUNTING AND ACTUARIAL PROFESSIONALS, IT IS AT BEST PREMATURE FOR CONGRESS TO MANDATE A UNIFORM STANDARD ON THE STATES AND THEIR POLITICAL SUBDIVISIONS.

IN VOICING OUR CONCERNS OVER THE PROPOSED PERISA LEGISLATION WE DO NOT INTEND TO MINIMIZE THE PROBLEMS WHICH STILL ARE PRESENT IN MANY STATE EMPLOYEE RETIREMENT PLANS. STATE OFFICIALS HAVE LONG RECOGNIZED THE NEED FOR REFORM OF STATE AND LOCAL PENSION SYSTEMS. THE FACT THAT NCSL CREATED A PENSION COMMITTEE IS A CLEAR REFLECTION OF THE RECOGNITION OF THE NEED FOR STATE IMPROVEMENT IN

THE PENSIONS AREA. IN CONJUNCTION WITH THE ESTABLISHMENT OF NCSL, A PENSIONS TASK FORCE WAS CREATED TO RESPOND TO THE INTERESTS IN THIS SUBJECT AMONG STATE LEGISLATORS. THE WORK OF THE TASK FORCE AND THE EFFORTS OF THE MANY STATE LEGISLATORS WHO PARTICIPATED WERE INSTRUMENTAL IN PUBLICIZING THE NEED FOR REFORM OF STATE PLANS. IN MORE THAN HALF OF THE STATES, THE TASK FORCE HAS HELD SEMINARS AND PROVIDED TECHNICAL ASSISTANCE FOR STATE LEGISLATORS. IN 1980, THE TASK FORCE WAS ELEVATED TO ONE OF THE TEN STANDING STATE FEDERAL COMMITTEES OF NCSL. THE COMMITTEE HAS CONTINUED THE WORK OF THE TASK FORCE AND FORMALLY ENDORSED THE PRINCIPLES OF PENSION REFORM WHICH ARE ATTACHED.

THE GOVERNORS HAVE ALSO HAD LONG-STANDING POLICY IN THIS AREA. (SEE ATTACHED). THE NGA SUBCOMMITTEE ON PUBLIC RETIREMENT SYSTEMS RECENTLY PUBLISHED PENSION GUIDELINES WHICH ENCOURAGE STATES TO CONTINUE TO GIVE HIGH PRIORITY TO THE REFORM OF PUBLIC RETIREMENT SYSTEMS INCLUDING THE USE OF APPROPRIATE METHODS OF REPORTING AND DISCLOSURE, AND ADEQUATE FUNDING OF BENEFIT COSTS.

IN RECOGNITION OF THE NEED FOR PENSION REFORM, MANY STATES HAVE ADOPTED LEGISLATION OR IMPLEMENTED PROCEDURES TO INITIATE THE PROCESS. IN 1975, ONLY FOUR STATE LEGISLATURES HAD STANDING LEGISLATIVE COMMITTEES WHICH DEALT WITH PENSIONS; NOW OVER HALF OF THEM DO. IN CONTRAST TO THE UNCERTAIN FISCAL IMPLICATIONS OF PENSION LEGISLATION PASSED A DECADE AGO, MOST STATES NOW REQUIRE A FISCAL OR ACTUARIAL EVALUATION BEFORE LEGISLATION CAN BE CONSIDERED. AS RECENTLY AS 1978, ONLY A DOZEN STATES HAD PENSION

COMMISSIONS. TWENTY-NINE HAVE EITHER CREATED PENSION COMMISSIONS OR ARE IN THE PROCESS OF DOING SO TODAY. THESE COMMISSIONS, WHICH SERVE AS SOURCES OF EXPERTISE ON STATE PENSION POLICY, ARE AN IMPORTANT ELEMENT IN PROVIDING INFORMATION NECESSARY TO IMPLEMENT REFORM STRATEGIES.

DURING 1981, LEGISLATION TO ESTABLISH A PENSION COMMISSION WAS APPROVED IN THE STATES OF MICHIGAN AND PENNSYLVANIA. THE MICHIGAN LEGISLATION REQUIRES THE COMMISSION TO EVALUATE AND MAKE RECOMMENDATIONS ON ALL PUBLIC PLANS. IN PENNSYLVANIA, THE STATUTE ESTABLISHES A STRONG STATE OVERSIGHT ROLE AND SETS AS A FIRST PRIORITY FOR THE COMMISSION THE EVALUATION OF ALL MUNICIPAL SYSTEMS. IN ADDITION, THE COMMISSION IS CHARGED WITH RECOMMENDING LEGISLATION TO ESTABLISH A RECOVERY PROGRAM FOR FINANCIALLY DISTRESSED MUNCIPALITIES.

STATES HAVE ADOPTED A VARIETY OF APPROACHES IN IMPROVING THE STATE AND LOCAL PENSION PLANS. MINNESOTA, MONTANA, NEW JERSEY AND WASHINGTON HAVE CREATED STATE ADMINISTERED PLANS FOR LOCAL GOVERNMENTS AND REQUIRE MUNICIPALITIES TO CEASE CREATING NEW PLANS. WISCONSIN HAS JOINED THE STATES OF HAWAII AND SOUTH DAKOTA IN IMPLEMENTING A SINGLE CONSOLIDATED PLAN FOR ALL EMPLOYEES. OREGON HAS A STRONG REPORTING AND DISCLOSURE STATUTE AND HAS RECENTLY RECEIVED AN AWARD FROM THE MUNICIPAL FINANCE OFFICERS FOR EXCELLENT IN THEIR FINANCIAL REPORTING STANDARDS. NEVADA HAS DEVELOPED A COMPREHENSIVE INFORMATION PROGRAM FOR PLAN MEMBERS AND CALIFORNIA REQUIRES REPORTING OF PENSION INFORMATION BY LOCAL GOVERNMENT AND HAS PUBLISHED A COMPILATION OF THESE REPORTS. FLORIDA NOW

REQUIRES ALL LOCAL GOVERNMENTS TO PREPARE ACTUARIAL VALUATIONS EVERY THREE YEARS AND TO SUBMIT THEM TO THE STATE FOR REVIEW. THESE VALUATIONS MUST INCLUDE A 40-YEAR AMORTIZATION PLAN FOR UNFUNDED LIABILITIES WHICH ARE THE BASIS FOR CONTRIBUTIONS TO THE LOCAL PLAN. FAILURE TO COMPLY WITH THESE CONDITIONS RESULT IN A DECLARATION OF FINANCIAL EMERGENCY AND TEMPORARY ASSUMPTION OF LOCAL BUDGET AUTHORITY BY THE STATE. THIS APPROACH ENSURES THE SOUNDNESS OF LOCAL PENSION PLANS AND GUARANTEES THE PENSIONS OF PUBLIC EMPLOYEES. IN MARCH 1981, FLORIDA'S ANNUAL REPORT ON LOCAL RETIREMENT SYSTEMS NOTED THAT OVERALL THE PROGRAM IS WORKING WELL AND LOCAL GOVERNMENTS HAVE BEEN COOPERATIVE.

WHILE THERE IS A DIVERSITY OF STATE EXPERIENCES, SOME TRENDS HAVE EMERGED. STATE ADMINISTERED SYSTEMS COVER ABOUT 90% OF ALL STATE AND LOCAL PENSION PARTICIPANTS. ACCORDING TO SURVEYS NCSL CONDUCTED IN COOPERATION WITH THE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS IN 1979, THESE SYSTEMS HAVE EXTENSIVE REPORTING AND DISCLOSURE REQUIREMENTS. THE LARGE MAJORITY OF THEM REQUIRE REGULAR ACTUARIAL VALUATIONS, AUDIT REPORTS TO STATES AND EMPLOYEES, AND FISCAL NOTES. SOME STATES REQUIRE THIS REPORTING BY STATUTE, OTHERS DO IT BY ADMINISTRATIVE REGULATION, AND STILL OTHERS BY POLICY OR CUSTOM.

DURING THE LAST YEAR, STATES AS DIVERSE AS TENNESSEE, LOUISANA AND TEXAS HAVE ALL PASSED LEGISLATION REQUIRING ANNUAL REPORTS. THE LOUISANA STATUTE REQUIRES THAT THE REPORTS INCLUDE A FIVE YEAR CASH FLOW PROJECTION FOR PUBLIC PLANS. IN TEXAS, THE LEGISLATION REQUIRES THAT PLAN MEMBERS RECEIVE A SUMMARY OF THE PLAN BENEFITS: CHANGES AFFECTING

CONTRIBUTIONS AND A STATEMENT OF THE MEMBER ACCUMULATED CONTRIBUTION. IN YOUR OWN STATE OF RHODE ISLAND, MR. CHAIRMAN, THIS ISSUES IS CURRENTLY UNDER CONSIDERATION BY A SPECIAL COMMISSION ESTABLISHED LAST YEAR WHICH INCLUDES REPRESENATIVES OF LABOR, MUNICIPALITIES AND THE LEGISLATURE INCLUDING THE CHAIRMAN OF THE JOINT COMMITTEE ON RETIREMENT. THE CHAIRMAN HOPES TO BRING FORTH RECOMMENDATIONS FOR THE 1983 SESSION.

OUR PENSION SURVEYS SHOWED A CONTINUING LEGISLATIVE INTEREST IN PENSION POLICY AND A WIDE VARIETY OF APPROACHES TO PENSION REFORM. NOT ALL OF THE PROPOSAL WILL NECESSARILY MEET THE STANDARD OF THE PERISA LEGISLATION; BUT ALL REPRESENT IMPROVEMENT IN CURRENT PLANS AND PROGRESS TOWARD A COMMON GOAL OF ENSURING PROTECTION OF PENSION BENEFITS WHILE NOT PLACING AN UNNECESSARY BURDEN OF PENSION COSTS ON CURRENT AND FUTURE TAXPAYERS.

STATES HAVE TAKEN GREAT STRIDES NOT ONLY IN THE INTEGRATION AND MANAGEMENT OF THEIR SYSTEMS BUT ALSO IN THEIR FUNDING METHODS. IN MY OWN STATE OF MARYLAND, WE ARE ENGAGED IN A CONTINUAL EFFORT TO UPGRADE OUR PENSION SYSTEM. IN 1975, RECOGNIZING THE NEED FOR IMPROVEMENTS IN OUR SYSTEM, WE PASSED LEGISLATION ESTABLISHING A SPECIAL PENSION COMMITTEE TO EVALUATE OUR PLAN AND TO MAKE RECOMMENDATIONS TO THE LEGISLATURE. IN 1977, WE PASSED TWO BILLS AFFECTING OUR CURRENT SYSTEM. ONE ESTABLISHED FIDUCIARY STANDARDS AND THE OTHER REQUIRED ACTUARIAL ANALYSIS OF ALL PENSION BILLS. THIS LEGISLATION WAS FOLLOWED BY CHAPTER 757 OF THE ACTS OF 1978 REQUIRING ANNUAL REPORTING BY LOCAL GOVERNMENTS. FINALLY, IN 1979

WE ESTABLISHED A NEW PENSION SYSTEM INTEGRATED WITH SOCIAL SECURITY AND BASED ON A FULLY-FUNDED STATE SYSTEM. WE EXPECT THAT ADDITIONAL REFORMS WILL BE UNDERTAKEN IN THE FUTURE. I MENTION THE EXPERIENCE OF MY OWN STATE NOT ONLY TO SPECIFY OUR ACTIVITIES BUT ALSO TO ILLUSTRATE THAT PENSION REFORM IS A LONG AND COMPLEX PROCESS WHICH TAKES TIME TO ENACT AND IMPLEMENT.

THE RECENT URBAN INSTITUTE STUDY, THE FUTURE OF STATE AND LOCAL PENSION SYSTEMS, ASSESSED THE ADEQUACY OF LARGE PENSION PLANS, THOSE CONTAINING 1,000 OR MORE MEMBERS. THE RESULT OF THIS STUDY SHOWED THAT BENEFIT ADEQUACY, MEASURED BY THE DEGREE TO WHICH PENSION PLANS REPLACED PRE-RETIRMENT DISPOSAL INCOME, WAS QUITE GOOD. ON A WEIGHTED AVERAGE BASIS, AN EMPLOYEE WITH 30 YEARS OF SERVICE RETIRING AT AGE 65 WITH A FINAL SALARY OF $10,000 RECEIVED 109% OF DISPOSABLE INCOME; AT $20,000, THE PENSION STILL REPLACED 96% OF DISPOSABLE INCOME. THIS STUDY HAS PARTICULAR RELEVANCE IN DISCUSSIONS OF BENEFIT ADEQUACY SINCE LARGE PLANS COVER OVER 90% OF ALL PUBLIC EMPLOYEES.

IT IS MY UNDERSTANDING THAT THE FEDERAL CIVIL SERVICE IS NOW SUBJECT TO REPORTING AND DISCLOSURE REQUIREMENTS. I WOULD URGE YOU TO CLOSELY EXAMINE THE METHOD OF REPORTING. REPORTING REQUIREMENTS ARE NOT USEFUL IF NOT BEING PERFORMED IN A FISCALLY SOUND MANNER. THE FEDERAL GOVERNMENT REPORTING IS BASED ON STATIC ASSUMPTIONS WHICH DO NOT RECOGNIZE THE SUBSTANTIAL IMPACT OF INFLATION ON PENSION PLANS. IN OUR REFORM OF THE PENSION SYSTEM IN MARYLAND, WE REQUIRE THE USE OF A DYNAMIC METHOD IN ESTIMATING

COSTS. THIS TYPE OF SYSTEM DOES FACTOR IN A METHOD OF ASSESSING INFLATIONARY COST INCREASES. I RESPECTFULLY SUGGEST THAT THE COMMITTEE EVALUATE THE EFFECTS OF THIS TYPE OF REPORTING.

THERE IS A LARGE ROLE FOR THE FEDERAL GOVERNMENT TO PLAY IN STRENGTHENING ALL PENSION SYSTEMS, BOTH PUBLIC AND PRIVATE, AND AT THE SAME TIME SAVE OUR TAXPAYERS BILLIONS OF DOLLARS. IF THE FEDERAL GOVERNMENT IS WILLING TO TAKE THE NECESSARY STEPS TO STOP THE INFLATION THAT IS WREAKING HAVOC WITH ALL PENSION SYSTEMS THEN IT WILL DESERVE ALL THE ACCOLADES AND PRAISE THAT OUR NATION CAN MUSTER.

INFLATION IS THE NUMBER ONE ENEMY OF SOUND PENSION POLICY IN AMERICA. BRING IT UNDER CONTROL, AND THE REMAINING PROBLEMS WILL BE EASILY PUT RIGHT. WE FIRMLY BELIVE THAT THE STATES HAVE DONE FAR MORE TO MEET THEIR PENSION PROBLEMS THAN THE FEDERAL GOVERNMENT HAS DONE TO MEET ITS. IF CALCULATED AS OF DECEMBER 31, 1981, THE UNFUNDED LIABILITY OF THE 39 FEDERAL PENSION SYSTEMS EXCEED THE $1 TRILLION NATIONAL DEBT AND ARE GROWING AT A MUCH FASTER RATE. IT IS A MATHEMATICAL CERTAINTY THAT WE WILL FAIL FINANCIALLY IF A BEGINING IS NOT MADE TO BRING THE FEDERAL PENSION PROBLEM UNDER CONTROL BY THIS CONGRESS.

THE STATES ARE MORE UNITED IN THEIR OPPOSITION TO PERISA LEGISLATION THAN ON ANY OTHER MATTER WHICH HAS COME BEFORE US IN MANY YEARS. WE CALL ATTENTION TO THE DECISION OF THE SUPREME COURT IN THE <u>NATIONAL LEAGUE OF CITIES V. USERY</u> CASE IN WHICH THE

SUPREME COURT HELD THAT THE FEDERAL COMMERCE POWER COULD NOT BE USED TO IMPOSE FEDERAL MINIMUM WAGE STANDARDS ON LOCAL GOVERNMENTS. THE SPIRIT OF THIS HOLDING SUGGESTS THAT THE NOTION OF FEDERALISM AND THE SEPARATION OF POWERS WOULD NOT BE UPHELD IF THE PROPOSED LEGISLATION WERE ENACTED.

STATES HAVE A LONG AND SUCCESSFUL RECORD OF IMPROVEMENT IN STATE AND LOCAL EMPLOYEE RETIREMENT PLANS. IN LIGHT OF THE CONTINUED ACTIVITY IN THE STATES AND THE LONG LIST OF ACCOMPLISHMENTS, IT IS OUR BELIEF THAT THE LEVEL OF GOVERNMENT BEST SUITED TO CONTROL PUBLIC EMPLOYEE PENSION PLANS ARE THE STATES AND LOCAL GOVERNMENTS. WE URGE YOU TO CONTINUE THE WORK WHICH WAS STARTED BY THE CONGRESS LAST YEAR TO REDUCE THE REGULATORY BURDEN ON STATE GOVERNMENT RATHER THAN TO IMPOSE A NEW AND UNNECESSARY REGULATORY STRUCTURE.

I HAVE ATTACHED TO MY WRITTEN STATEMENT OUR PENSION COMMITTEE'S LIST OF PRINCIPLES FOR PENSION REFORM. I REGRET THAT WE CAN NOT AGREE ON THE PROVISIONS OF THE PROPOSED LEGISLATION AND I AM CONFIDENT THAT THE GOALS OF THE COMMITTEE IN INSURING FINANCIAL SECURITY FOR STATE AND LOCAL EMPLOYEES WILL BE REALIZED THROUGH THE CONTINUING EFFORTS OF STATE LEGISLATORS AND GOVERNORS.

NCSL POLICY POSITION

PUBLIC PENSION REFORM PRINCIPLES

NCSL STRONGLY SUGGESTS THAT THE STATES ABIDE BY THE FOLLOWING PRINCIPLES TO ENSURE SOUND PENSION POLICIES:

- O CREATING A PERMANENT LEGISLATIVE COMMISSION WITH STAFF AND ACTUARIAL ASSISTANCE WITH RESPONSIBILITY FOR RECOMMENDING LEGISLATIVE CHANGES;

- O REQUIRING ALL PUBLIC FUNDS TO REPORT ANNUALLY TO THE LEGISLATURE ON A UNIFORM BASIS;

- O PROHIBITING CHANGES IN PENSIONS BENEFITS OR CONTRIBUTIONS BY ANY BODY OTHER THAN THE STATE LEGISLATURE;

- O STATUTORILY PROHIBITING COLLECTIVE BARGAINING ON PUBLIC PENSIONS;

- O IMPOSING A MORATORIUM ON ANY REDUCTION IN THE AGE OF RETIREMENT UNTIL A COMPLETE ANALYSIS OF THE PENSION PLAN IS COMPLETED;

- O REQUIRING COMPETENT FISCAL NOTES ON ALL PROPOSED PENSION LEGISLATION;

- O DEVELOPING MECHANISMS TO REDUCE PENSION HOPPING AND DOUBLE DIPPING;

- O CONSOLIDATING STATE AND LOCAL GOVERNMENT PENSIONS SYSTEMS INTO ONE PLAN;

- O PERIODICALLY RE-EXAMING DISABILITY ROLLS;

- O REQUIRING LEGISLATION WHICH WOULD INCREASE PENSION BENEFITS TO ALSO CONTAIN FRONT-END FUNDING ON A SOUND ACTUARIAL BASIS, AND

- O INTEGRATING ALL STATE AND LOCAL SYSTEMS WITHIN SOCIAL SECURITY.

PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT

NCSL IS AWARE OF THE VITAL ROLE WHICH PUBLIC RETIREMENT SYSTEMS HAVE ASSUMED IN THE ARENA OF NATIONAL PENSION POLICY. A GROWING NUMBER OF STATE LEGISLATURES HAVE RECOGNIZED PENSION PROBLEMS AND COMMITTED THEMSELVES TO LONG RANGE ACTUARIALLY SOUND FUNDING THROUGH THE CREATION OF PENSION COMMITTEES AND COMMISSIONS WITH THE CONCOMMITANT DEVELOPMENT OF A HIGH LEVEL OF PENSION EXPERTISE THROUGH PROFESSIONAL STAFF AND ACTUARIAL ASSISTANCE.

THEREFORE, NCSL RESOLVES THAT:

- O THE PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT AND ANY SIMILAR PROPOSALS BE OPPOSED AS A SERIOUS USURPATION OF THE SOVEREIGN POWER OF THE STATE AND LOCAL GOVERNMENTS;

- O THE MORE THAN 7,000 STATE AND LOCAL RETIREMENT SYSTEMS IMPLEMENT OR CONTINUE IN THEIR EFFORTS TO BRING FISCAL INTEGRITY TO THEIR PENSION SYSTEMS; AND

- O THE FEDERAL GOVERNMENT, WHOSE TAXING POWERS IMPACT THE CITIZENS OF EACH OF OUR RESPECTIVE STATES, DIRECT ITS EFFORTS TOWARD CONTROLLING ITS OWN PENSION DEFICIT OF OVER $1 TRILLION AND BEGIN TO IMPLEMENT PROGRAMS NOW BEING ADOPOTED BY SEVERAL STATES TO CORRECT SERIOUS PROBLEMS IN THE FEDERAL PENSION SYSTEM.

NGA POLICY POSITION

PUBLIC PENSION PLANS

WE RECOGNIZE THE VITAL IMPORTANCE OF ADEQUATE AND ASSURED PENSIONS FOR EMPLOYEES OF PUBLIC ENTITIES.

ALTHOUGH THE INFORMATION CURRENTLY AVAILABLE ON PUBLIC PENSION PLAN IS INADEQUATE, RECENT STUDIES HAVE SHOWN THAT SOME FEDERAL, STATE, AND LOCAL PUBLIC RETIREMENT SYSTEMS FAIL TO MEET APPROPRIATE REPORTING, DISCLOSURE, FIDUCIARY, AND FUNDING STANDARDS.

STATE ROLE

THE PRIMARY RESPONSIBILITY FOR REGULATING STATE AND LOCAL PENSION PLANS RESTS WITH STATE GOVERNMENT. MOST STATES NOW PROVIDE FOR REGULATION OF PUBLIC PLANS, AND MANY JURISDICTIONS ARE REEXAMINING THEIR CURRENT PRACTICES IN LIGHT OF RECENT FINDINGS. WE ENCOURAGE STATES TO CONTINUE TO GIVE HIGH PRIORITY TO THE STUDY OF THE PUBLIC RETIREMENT SYSTEMS WITHIN THEIR JURISDICTIONS AND TO TAKE ANY CORRECTIVE ACTION THEIR STUDIES INDICATED IS NEEDED.

THIS ACTION SHOULD BE DIRECTED TOWARD ASSURING:

(1) USE OF APPROPRIATE METHODS OF REPORTING AND DISCLOSURE;

(2) REGULAR INDEPENDENT FINANCIAL AUDITS CONDUCTED BY AN

AUDITOR NOT EMPLOYED BY THE RETIREMENT SYSTEM;

(3) REGULAR ACTUARIAL EVALUATIONS, USING ACCEPTED AND CURRENT ASSUMPTIONS;

(4) ADEQUATE FUNDING OF BENEFIT COSTS;

(5) REEAXAMINATION OF CURRENT BENEFIT PROVISIONS AND REVISION WHERE NECESSARY TO ENSURE THAT ABUSES OF THE SYSTEM ARE ELIMINATED;

(6) ESTABLISHMENT OF GUIDELINES FOR THE CONDUCT OF FIDICIARY RESPONSIBILITIES, PARTICULARLY THOSE RELATED TO THE SELECTION OF INVESTMENT ADVISORS, BROKERS AND CUSTODIANS, AND INVESTMENT POLICIES;

(7) ENCOURAGEMENT, WHERE FEASIBLE, OF PLAN CONSOLIDATION; AND

(8) ENCOURAGEMENT, WHERE FEASIBLE, OF PORTABILITY OF MEMBERSHIP.

FEDERAL ROLE

GIVEN THE SOVEREIGNTY OF STATES, THE RECENT STATE ACTIONS TO IMPROVE THEIR PLANS, AND THE SUBSTANTIAL PROBLEMS THAT HAVE ARISEN IN THE IMPLEMENTATION OF ERISA, WE OPPOSE FEDERAL PREEMPTION OF THE REGULATION AND MANAGEMENT OF PUBLIC PENSION PLANS.

Senator CHAFEE. Well, thank you very much, Senator. I believe you were here when I had my opening remarks and during my discussion with Congressman Erlenborn; I noted then that the Federal Government is hardly taking a position of accusing anybody of anything in connection with pensions. What we are trying to do is to get everybody to let the beneficiary know what is going on and cast, if you will, a spotlight on the whole problem.

It is splendid that the States are doing what they are, as you mentioned. Senator Paul Hannoway, of my own State, has been very active in this effort. I think that is beneficial.

Frankly, I see nothing for the States to fear, if you want to use the word, from this legislation. This legislation simply says, look; we do not want to remain in this business. The requirements on the States are very modest. I suspect many are meeting them already.

Mr. CLARK. If I could add, sir, one more thing. You asked if there was any model legislation. Texas has just passed a year ago a requirement that requires semiannual reports of all State pension systems to a State pension board. As to the condition and all of the actuarial data and all of that sort of thing, I would think that that would certainly be—and State after State are doing this.

What I am really saying is that the States have recognized their problems and have moved to meet them.

Senator CHAFEE. All right, Mr. Natale.

STATEMENT OF JOSEPH P. NATALE, EXECUTIVE SECRETARY, COLORADO PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION

Mr. NATALE. Good morning, Mr. Chairman. I am Joseph Natale, executive secretary of the Colorado Public Employees' Retirement Association. I am here today representing the Municipal Finance Officers Association. Our plan in Colorado has about 105,000 active members and about 20,000 retired. Asset size is $2.9 billion.

Mindful today of the length of today's hearing and of the committee's time, I have previously submitted a statement of written testimony on behalf of the Municipal Finance Officers Association, which I hereby request to be included in the record.

Senator CHAFEE. Yes; that will be done. You also heard the nice things people said about Colorado in the previous testimony.

Mr. NATALE. We are very appreciative of Mr. Schaitberger's remarks.

In my oral remarks, Mr. Chairman, I have six basic points which I would very briefly refer to, as follows:

First, there has been some reference made to the Urban Institute study. State and local pension funds have made, and are continuing to make, substantial funding progress according to the Urban Institute study sponsored by HUD, a study which was issued in March of 1981. This study establishes that the statements found in the House Pension Task Force study in 1976 through 1978 are incorrect, weakly researched, and unfounded.

Rather, the HUD study indicates that over a 50-year period beginning with 1977 and extending to the year 2027, that State plan funding condition will improve and that employer contributions and consequently reliance upon tax funds is expected to remain level.

Senator CHAFEE. Now, of course, you realize this legislation goes far beyond States, though. When you say States, are you talking about all pension activities within a State—municipal and county and so forth?

Mr. NATALE. I am talking here, sir, about the Urban Institute study which included what was defined in the Urban Institute study as large plans. These were plans composed of 1,000 or more members. This comprises 95 percent of the membership of all State and local employees.

Second, the superior performance reported for State and local government is in stark contrast to the condition of 39 federally controlled retirement plans, not including social security, which have a reported unfunded accrued liability of $1 trillion. As Senator Clark has stated, that is on the use of static assumptons.

Although the current proposed legislation does not include funding standards, it is apparent that the Federal Government's control of its own retirement systems has not been and should not be a role model for State and local governments to emulate.

One of the principal House sponsors, a man who was here today, Congressman Erlenborn, has already publicly declared his frustration with the inability of Congress to control the Federal problem.

Third, proposed PERISA legislation will lead to the imposition of additional regulation, on the Federal level, of State and local retirement systems. We have had many unfortunate experiences with the Federal Government regulators and the regulations they promulgate.

In many cases, the Federal Government's handling of State and local government problems has resulted in confusion, duplication, unnecessary cost, and ultimately the waste of the taxpayer's money. I think it is not unusual that what Congress intends to regulate, the regulators perhaps see in a different light.

We feel that such efforts are clearly not in the national interest and are in direct contravention of the separation-of-powers issue dealt with in the *National League of Cities* v. *Usery,* a 1976 Supreme Court decision.

Fourth, Colorado—and our State, we feel, is an outstanding example of what can and is being done on the local level—we are 7 years ahead of Maryland. Over the past 14 years, rigid actuarial standards have been prescribed in our State by statute. We do have annual evaluations of active and retired lives, and we have an annual gain-loss actuarial analysis. We have upgraded our actuarial and economic assumptions within a 5-year cycle.

Reference has been made to the National Governors' Association. I have a copy of their standards with me. We meet all National Governors' Association standards for disclosure. We have acted responsibly in the investment of our funds, prudently but conscious of our responsibility to our community.

We comply with GAAP, generally accepted auditing principles, and with the Financial Accounting Standards Board Statement No. 35. Our standards meet and surpass all ERISA requirements.

We fail to understand why the majority of plans like ours should be penalized because in a few States improvements have not been made.

Fifth, the Municipal Finance Officers Association has consistently over a long period of time expanded efforts to urge the self-improvement of its membership through its publication of guidelines and standards, such as the Guidelines for the Preparation of a Public Employee Retirement System Comprehensive Annual Financial Report, a copy of which I have with me; and through its conformance award pronouncements and its instructional seminars.

PERISA will not aid and assist such professional selfimprovement since the energies and resources presently used to reform and improve State and local plans will be turned to meet compliance standards if PERISA is enacted, seriously thwarting the efforts of local and State retirement administrators.

Sixth, ERISA became law 8 years ago. I think it was signed on Labor Day by President Ford. ERISA oversight has been marked by controversy and excessive delays in implementation, starting with the confused jurisdictional dispute between Treasury and Labor, which leads to a proposal in one of the bills before you today to establish an Employee Benefit Administration. There are clear indications that ERISA is discouraging improvement and expansion of private pension plans.

Further, there are currently hearings about the multiemployer provisions of ERISA concerning withdrawal liability which, in the words of some of the witnesses, are threatening the existence of some unionized employers, inhibiting potential sales and mergers, and reducing the ability of some firms to borrow money. That is all according to current testimony before a Senate labor subcommittee.

ERISA currently demonstrates the regulatory problems involved and cannot by any stretch be termed a success. Why should such errors be compounded and repeated in the public sector? We respectfully urge the defeat of all PERISA legislation.

Mr. Chairman, we want to thank you and your committee for providing us with the opportunity to present our position on this legislation and to describe to you our efforts to continually improve the operation of public pension plans.

[The statement of Mr. Natale follows:]

TESTIMONY

OF

JOSEPH P. NATALE
EXECUTIVE SECRETARY
COLORADO PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION

ON

S 2105 AND S 2106
PUBLIC EMPLOYEE RETIREMENT INCOME
SECURITY ACT OF 1981

BEFORE THE

SENATE FINANCE SUBCOMMITTEE ON
SAVINGS, PENSIONS, AND INVESTMENT POLICY
COMMITTEE ON FINANCE

Monday, March 29, 1982
Room 2221
Dirksen Senate Office Building

Mr. Chairman and members of the Subcommittee, I am Joseph Natale, Executive Secretary, Colorado Public Employees Retirement Association, Denver, Colorado. I am testifying on behalf of the Municipal Finance Officers Association (MFOA) as a member of the Committee on Public Employee Retirement.

We appreciate this opportunity to present the views of state and local government finance officers on S 2105 and S 2106, legislation cited as the "Public Employee Retirement Income Security Act of 1981" (PERISA).

The Municipal Finance Officers Association represents 9,000 members who are state and local government finance officials, appointive or elective, and public finance specialists. Included in the MFOA membership are public employee retirement system administrators, such as myself, who are responsible for the day-to-day operation and supervision of public pension plans. I feel that it is important for this Subcommittee to recognize that state and local government finance officers have many years of experience with public employee retirement systems and we are applying this expertise to new developments.

As the financial managers in our nation's cities, counties, and state governments, we have a responsibility to plan for the long-range financing of our governments. To fulfill this responsibility, we must pay close attention to the costs and future liabilities of public employee retirement systems and make sure that they are properly administered and financed.

Federal Regulation

The most significant area of concern we have with the PERISA bill is that of federal intervention in state and local government employer-employee issues. As state and local government officials, we have many unfortunate experiences with federal government regulators and the regulations they promulgate. In many cases, the federal government's handling of state and local government problems has resulted in confusion, duplication, unnecessary costs, and, ultimately, the waste of taxpayer dollars. These problems would surely surface if federal agencies were charged with the regulation of state and local government pension systems. ERISA has been in effect for 8 years and there remains a myriad of problems with the legislation and the federal regulations implementing the law. As practitioners, we are concerned that if PERISA is enacted, state and local government officials would be so preoccupied with compliance that they will have less time to devote to implementing improved financial management practices. The excessive delays in issuing federal regulations for the Employee Retirement and Income Security Act (ERISA) are examples of the problems associated with federal regulations. Thus, while the concept of a limited federal regulatory role may be appealing to some, the practical real world implementation of federal control may be less efficient than you hope.

There is no evidence that state and local government retirement systems have adversely affected either our securities market or the national economy as a whole. Some argue that the mere size of public employee retirement plans dictates that they will affect both the securities market and the national economy. Please be assured that in managing our Systems, and particularly in making our investments, we are prudent and avoid actions that adversely affect either the securities market or the national economy.

I would also like to point out that the information which is provided to security rating firms, investors, and others involved in the purchase of municipal bonds includes reporting on the finances of public employee retirement systems. Investors and other participants in the municipal bond market are well aware of the financial needs of public employee retirement systems and recognize the demands that the retirement systems could place on the fiscal capacity of state and local governments.

In the past decade, state and local government officials and the organizations in which we participate have recognized the problems facing our public employee retirement systems. We are also aware that certain pension systems are in need of improvement and I believe that we are engaged in constructive efforts to bring about this needed reform. It is incumbent upon me to point out that the vast majority of state and local government employees are covered by pension plans which are professionally administered and whose finances are in order.

Much of the basic support for PERISA legislation originated with the Pension Task Force Report on PERS authorized by the U.S. House of Representatives Committee on Education and Labor which concluded, in 1978, that state and local retirement plans had insufficient regulation to "protect the vital national interests" involved.

Early in 1980, the General Accounting Office (GAO) concluded a study by stating that "under its assumptions a worsening financial status for state and local plans in the aggregate is certain."

However, in 1981, the HUD study, performed by the Urban Institute related to 50 year forecasts of funding condition under a variety of funding policies. The study results are representative of all large defined benefit state and local plans.

Complete reference to the full study is, of course, available to the Congress. Based upon actuarial calculations and valuations at the end of each year during the 50 year period from 1977 to 2027, employer contribution rates, as a percent of payroll, fell from 12.7% in 1980 to 8.6% in 2024. Measured according to each plan's funding method and valuation assumptions but using actual experience according to standard economic assumptions, the average plan funded ratio was 56% in 1980 which grows to 82% in 2024. The Ratio Of Unfunded Liability To Payroll is less than 1 for the median large plans in 1977 and will decrease to below .2 in 2027. Even if a 5% COLA is added, contribution rates and funded ratios are not materially affected over the next 50 years.

There are a few examples of benefit excess and poor funding policy but these are notable by being the exception, not the rule, and the excesses of the few do not justify punitive regulation of the majority.

Further, the superior funded condition of state and local retirement plans generally disclosed by the HUD study disputes the House Pension Task Force data directly and, because the HUD study was well researched and financed, should put to rest the alarmists who talk about poor funding standards. The fact is that progress is being made in state and local retirement system funding. Contrast this with the statement of Representative John Erlenborn (R-Ill), one of PERISA's staunch advocates that the "unfunded liability of 39 federal pension plans (not including Social Security) exceeded $1 trillion during fiscal 1981." (Volume 9, No. 377, January 25, 1982 BNA Pension Reporter) Representative Erlenborn further stated that he was "merely presenting the facts, not offering any solutions to the problems."

Therefore, we are prompted to observe that if the federal government cannot solve its own pension problems, how does it expect to solve ours?

Colorado Experience

We are justifiably proud of the progress made in Colorado without the necessity of external "prodding" from the Federal Government. Our record shows amendments made in 1969 concerning funding standards, disclosure and reporting to the Governor, the General Assembly, the State Auditor's Office, and to the membership generally, regarding the actuarial condition of the fund. We have met and exceeded the standards adopted in 1969 and currently meet and exceed ERISA funding standards applicable in the private sector. All benefits are set by law and employee and employer contribution rates are established by statute, which aids the budgeting process of state and local government. Fiscal notes are attached to all proposed pension legislation which must contain the actuarial level premium cost.

Our plan exceeds the reporting and disclosure guidelines promulgated by NGA. We send reports to our entire membership of 120,000 twice per year. Each new employee receives an easy to read description of plan benefits, all information on plan design, benefits, management, finances, and actuarial matters as provided in substantive conformity to NGA-guidelines.

Our auditing standards are in conformity with Generally Accepted Accounting and Auditing Principles and we are in conformity with the Financial Accounting Standards Board's pronouncement #35, even though we are not required to do so.

Our benefit design is reasonable, adequate but not excessive. For example, a 40-year member can qualify for 70% of the Final Average Salary (FAS). We are not covered by Social Security. Our post-retirement escalator is capped at 3% annually.

Our investment statute is a "prudent man" law. Recent legislation permits investment of up to 50% of our fund in equities. We are also investors in real estate, equity and debt alike. We have substantially recognized our commitment to Colorado's economy by increasing the percentage of our portfolio invested in Colorado from 1% to almost 20% in a six year period. We are currently working with Colorado Housing Finance Authority to commit up to $100 million in residential mortgage loans to lower income, first time homeowners, at reasonable rates, and yet rates which we can defend on a fiduciary basis.

We think we are responsible members of our community and of our economy and we repress the efforts of the Federal Government to tell us that we are not. If there are problems in state and local government, the proper recourse to solve those problems is at the state and local level.

We have rigidly followed and advocate conformity with following standards and efforts directed to professional self-improvement.

Development of Standards

The Municipal Finance Officers Association engages in a number of efforts aimed at improving the administration and financing of public employee retirement systems. In this regard, we analyze current pension problems and provide a broad-based program of pension related services, including research, training, technical assistance, and publications to bring about improvement of public pension systems. We have an extensive training program for those involved in the administration of public pension plans, including both intermediate and advanced courses and seminars.

Professional research is an integral part of the development and dissemination of effective financial management techniques, quality guidelines, and standards in the public pension area. The research arm of the MFOA, the Government Finance Research Center (GFRC), manages and performs research with immediate- and long-term usefulness to those engaged in the administration of public finance. Recently, the GFRC studied the investment of pension fund assets as well as the reporting and disclosure practices of state and local public employee retirement systems.

We believe that the guidelines which have been developed, adopted, and published by the Municipal Finance Officers Association prescribed the requirements and standards for proper management and for public disclosure to all interested parties regarding the operation of government as well as its public pension plans. The Disclosure Guidelines for State and Local Governments which were readily adopted by state and local governments, rating agencies, and the securities industry provide all information required for any interested party. We further believe that the Guidelines for the Preparation of a Public Employee

Retirement System Comprehensive Annual Financial Report will be used and followed by public employee retirement systems. We daily observe as reports cross our desks continued improvement in disclosure and reporting in keeping with these guidelines.

One of the actuarial disclosures under PERISA is the actuarial present value of accumulated plan benefits. This amount is not useful in determining funding requirements, periodic cost measurements, or meaningful solvency tests and is currently not being generated for most public plans. To generate this figure requires a separate actuarial calculation at a substantial cost to the plan. In a government setting, a disclosure of such figures misleads the beneficiaries and public as to the amount of benefit to be ultimately received. Such disclosure misleads the Legislature as to the true cost of the system over the lifetime of the member. This issue has been strongly debated by the retirement community, the Financial Accounting Standards Board (FASB), the National Council on Governmental Accounting (NCGA), and the American Institute of Certified Public Accountants (AICPA). The strong recommendation of the retirement community is that these figures should not be required.

The MFOA recommended disclosures are presented on an ongoing-plan basis and, thus, allow the reader to assess, on a long-term historical basis, a plan's financial position and financial condition. The PERISA disclosure requirements are presented on a plan termination basis and only inform the reader of the plan's ability to pay benefits if the plan would terminate at the date of the financial statements. Even an informed reader would be unable to assess the long-term ability of a retirement plan to pay benefits when due under the PERISA disclosure requirements. Disclosures as to plans ability to pay benefits can be quite precisely made in a manner which does not mislead anyone, yet gives full information upon which to base management and legislative decisions.

Comparison of MFOA Guidelines to PERISA Reporting Requirements

The reporting and disclosure provisions of the PERISA legislation are similar to those found in the ERISA law. The provisions of the proposed bill would require a summary plan description, an annual report, and a report on participant's benefit rights.

The MFOA Guidelines for reporting were developed by joint committees of MFOA which were comprised of independent actuaries, accountants, consultants, and pension plan administrators. Our primary purpose was to develop guidelines for the preparation of a comprehensive annual financial report. The major objectives of a report which is completed according to the guidelines are 1) to establish a periodic record of the operations of the system through the presentation of financial and statistical information; 2) to present the results of the system's operations from a managerial perspective; 3) to acquaint the pension plan members, employer, government officials, and general public with the financial condition of the system; and 4) to provide the information needed for making valid comparisons of operating results among other pension systems.

To meet these objectives, we concluded that the public employee retirement system report must contain audited basic financial statements which are prepared in conformity with generally accepted accounting principles along with actuarial and investment data accompanied by historical statistical data.

The MFOA Guidelines require a much more detailed overall disclosure of pension plan data than does the proposed PERISA which basically requires disclosure along the lines of that required by the Financial Accounting Standards Board's "Statement of Financial Accounting Standards 35." The Guidelines require that the report be comprised of and organized into four major sections: 1) Introductory; 2) Financial; 3) Actuarial; and 4) Statistical. The Guidelines then present the detailed disclosures required by each of these sections. The

PERISA disclosure requirements encompass only financial and actuarial data and do not require supplemental historical schedules.

The National Interest

While the state and local government community is taking steps to get our pension house in order, we see no evidence of progress with regard to pension plans covering federal employees. In reviewing the findings and declaration of policy which form the preamble to S 2105 and S 2106, we concluded that national policy could best be served if the federal government would adhere to the following declarations. "The growth in the size and scope of (federal) public employee pension benefit plans has been rapid and substantial..." "The maintenance and growth of such plans has a substantial and growing impact on Federal revenues..." (The federal government does) "not systematically fund retirement benefits accruing to (its) employees..." "Public pensions are becoming a large financial burden on (the federal) government and that burden will increase in the future"... "and (this) constitutes a serious threat to the future economic health of the Nation." (See S 2105 and S 2106)

The 1976 Supreme Court decision, National League of Cities v Usery, raises Constitutional questions concerning federal regulation and intervention in state and local government public employee retirement systems. In National League of Cities (NLC), the court invalidated Congress' 1974 extension of the wages and hours provisions of the Fair Labor Standards Act to state and local government employees. The National League of Cities argued that these amendments were unconstitutional as they infringed upon basic state governmental functions.

In a report prepared for the Universal Social Security Coverage Study group, Jesse H. Choper, Professor of Law, University of California, Berkley, indicates that "The court's opinion (in NLC, by Justice Rehnquist) stressed the 'significant' cost impact on state and local governments of the wages and hours provisions extension (although the court also stated that it did not 'believe particularized assessments of actual impact are crucial to resolution of the issues presented')." Choper also writes that "in NLC the court found that the wages and hours amendments would 'significantly' alter or displace the States' abilities to structure employer-employee relationships in furnishing public services."

The Municipal Finance Officers Association, in cooperation with the National Council on Governmental Accounting (NCGA), has consistently strived to meet the needs of the public relating to reporting and disclosure for state and local governments and public pension plans. The NCGA published the Governmental Accounting, Auditing and Financial Reporting handbook (GAAFR) which has been widely accepted and acknowledged as the primary authoritative statement on the application of generally accepted accounting principles for state and local governments.

The Municipal Finance Officers Association was, likewise, providing reporting and disclosure standards for public employee retirement systems through the publication of its handbook, Public Employee Retirement Administration. Not only does this publication provide decision-making and administrative information for pension system directors, but it also provides detailed guidance for reporting and disclosure.

Other State, Governor, Legislature, and Local Agency Activities

In additional to the MFOA employee retirement system financial reporting publications, other organizations serving various levels of state and local government have also been developing useful tools for the improvement of public pension plans. In 1978, the National Conference of State Legislatures published

A Legislator's Guide to Public Pensions. One of the recommendations of this Guide called for the ~~creation of pension commissions~~ in the states. Since the publication of the Guide, the number of such pension commissions and legislative retirement committees has increased from 12 to 22. These pension commissions serve as permanent research and advisory bodies providing guidance to state and local officials including pension plan trustees and administrators. The governors of the 50 states have also engaged in efforts to improve the administration of state and local plans. In February of 1981, the National Governors' Association published State Policy Guidelines for Public Employee Retirement Systems. These Guidelines are designed to serve as a checklist against which individual governors can evaluate their pension systems and, in fact, is bringing public pension policy issues to the desks of many governors.

Thus, state and local governments have made a commitment to improving their pension systems in the absence of federal regulations. We are confident that this practice will continue, especially in light of the efforts being brought to bear on the issue by the National Conference of State Legislatures, the National Governors' Association, the various State Pension Commissions, and particularly the Municipal Finance Officers Association.

Mr. Chairman, we want to again thank you and your committee for providing us with the opportunity to present our position on this legislation, and to describe to you our efforts to continually improve the operation of public pension plans.

Senator CHAFEE. Well, thank you, Mr. Natale.

No question but what Colorado is doing an outstanding job. I will ask you a question when Ms. Kreamer is through.

Please proceed, Ms. Kreamer.

STATEMENT OF BARBARA KREAMER, COUNCILWOMAN, HARFORD COUNTY, MD.

Ms. KREAMER. As far as I know, it is coincidental that there are two representatives from Maryland representing the four great organizations on the panel. I thank you for the opportunity to appear before you today on the important issue of State and local government pensions.

I am Barbara Osborne Kreamer, councilwoman from Harford County, Md., representing the National Association of Counties and the National League of Cities. I am chairwoman of the NACO Committee on Pensions and Employee Benefits, part of the Labor and Employee Benefits Steering Committee.

The two bills before us today, S. 2105 and S. 2106, are identical to H.R. 4928 and H.R. 4929, respectively, introduced in the House of Representatives. These bills are similar in intent and scope to bills introduced in the House in previous Congresses.

The National Association of Counties and the National League of Cities, upon consideration of these new bills, reaffirm our opposition to PERISA legislation as proposed in S. 2105 and S. 2106, for the following reasons:

No. 1, State and local government pensions are part of the basic personnel and compensation functions of those levels of government and should thus be regulated by those levels of government.

No. 2, over 90 percent of State and local government employees are covered by pension programs, and the vast majority of these are large or statewide pension systems, which are generally well adminstered and funded.

No. 3, State legislatures have taken giant strides in the past few years to set up pension committees and task forces and to reform and consolidate pension systems in their States.

No. 4, a major impetus for ERISA legislation, private-sector bankruptcies and defaults, simply does not exist in the public sector. To date there have been no defaults on State and local pension obligations of which we are aware.

No. 5, State governments, not the Federal Government, have the ultimate responsibility for pension obligations of their public plans and those of their jurisdictions. Therefore, they are the most appropriate level of government to regulate State and local government pensions.

No. 6, each State has diverse and unique conditions and retirement systems which warrant flexibility and control at the State government level rather than one uniform set of national standards.

No. 7, even limited standards which the PERISA Federal legislation would mold, over time, would result in increasingly strict, pervasive, and inflexible regulations and Federal bureaucratic policies.

No. 8, in addition to State legislation and oversight, there are free market forces, such as bond rating reviews and accounting certifications, which effectively reinforce sound funding and prudent administration.

No. 9, we fear that Federal regulation of State and local government pensions would inevitably be influenced by ERISA provisions and principles which would blur the real differences between public and private pension programs and their administration.

No. 10, the proposed legislation would add a plethora of new regulations, requirements, and paperwork mandates which would increase the cost, burdens, and complexity of pension administration for State and local governments.

No. 11, the proposed legislation may be unconstitutional, Senator Chafee, based upon the *National League of Cities* v. *Usery* Supeme Court decision, and clearly violates the spirit of that decision.

No. 12, there is is no compelling national interest or national crisis which has been hinted at today which warrants Federal intervention in the State and local government oversight, regulation, and administration of their pension plans.

No. 13, given the decided trend toward internal improvement and reform of pension policy at the State and local government level and the general Federal policy of returning more authority and responsibility for government services and programs to State and local governments, it is neither appropriate nor wise to enact new Federal authority and increased Federal regulation of this basic State and local government function.

On the one hand we are being told that we are ready to assume full responsibility for such diverse and major societal needs as welfare, food stamps, education, transportation, and social services. Yet we are then told that we are unequipped to handle a basic employer function such as pensions.

There are two contradictions which I heard this morning implied by this legislation. One was that Representative Erlenborn called for this legislation as a matter of rationalization. By that I assumed he meant establishing reasonableness. But a rationalization would certainly be needed to establish an Employee Benefits Administration against the current tide of the new federalism's return of responsibility to State and local governments.

Also, Representative Erlenborn implied that local politicos, as he terms us elected officials and retirement system officials, are collectively incapable of safeguarding pension plans, due, presumably, to the pressures of employee organizations.

However, ironically, supporters of his measure, including Mr. Sweeney, seem to believe that there will be more opportunity for control or at least monitoring with PERISA.

In sum, I thank you for the opportunity of appearing to express the objection of the National Association of Counties and the National League of Cities to any PERISA legislation.

[The statement of Ms. Kreamer follows:]

STATEMENT OF

THE HONORABLE BARBARA O. KREAMER, COUNCILWOMAN

HARFORD COUNTY, MARYLAND

ON BEHALF OF THE

NATIONAL ASSOCIATION OF COUNTIES

AND

THE NATIONAL LEAGUE OF CITIES

BEFORE THE

SENATE SUBCOMMITTEE ON SAVINGS,
PENSIONS AND INVESTMENT POLICY,
COMMITTEE ON FINANCE,

ON
S.2105 AND S.2106

MARCH 29, 1982

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STATEMENT OF THE HONORABLE BARBARA O. KREAMER, COUNCILWOMAN, HARFORD COUNTY, MARYLAND ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES AND THE NATIONAL LEAGUE OF CITIES BEFORE THE SENATE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY, COMMITTEE ON FINANCE, ON S.2105 AND S.2106, MARCH 29, 1982

I. OPENING REMARKS

THANK YOU FOR THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY ON THE IMPORTANT ISSUE OF STATE AND LOCAL GOVERNMENT PENSIONS. I AM BARBARA O. KREAMER, COUNCILWOMAN FROM HARFORD COUNTY, MARYLAND REPRESENTING THE NATIONAL ASSOCIATION OF COUNTIES (NACO)* AND THE NATIONAL LEAGUE OF CITIES (NLC). I AM CHAIRMAN OF THE NACO SUBCOMMITTEE ON PENSIONS AND EMPLOYEE BENEFITS OF THE LABOR-EMPLOYEE BENEFITS STEERING COMMITTEE.

THE TWO BILLS BEFORE US TODAY, S2105 AND S.2106, ARE IDENTICAL TO H.R.4928 AND H.R. 4929 RESPECTIVELY, INTRODUCED IN THE HOUSE OF REPRESENTATIVES. THESE BILLS ARE SIMILAR IN INTENT AND SCOPE TO BILLS INTRODUCED IN THE HOUSE IN PREVIOUS CONGRESSES. THE NATIONAL ASSOCIATION OF COUNTIES AND THE NATIONAL LEAGUE OF CITIES, UPON CONSIDERATION OF THE NEW BILLS, REAFIRM OUR OPPOSITION TO PERISA LEGISLATION AS PROPOSED IN S.2105 AND S.2106.

WE RECOGNIZE THAT THERE HAVE BEEN AND STILL ARE SOME PROBLEMS WITH THE STRUCTURES, FUNDING SITUATIONS, AND REPORTING AND DISCLOSURE POLICIES OF SOME STATE AND LOCAL GOVERNMENT PERSION PROGRAMS. WE BELIEVE THAT STATE AND LOCAL GOVERNMENT OFFICIALS RECOGNIZE THESE PROBLEMS, HAVE SHOWN THAT THEY CAN REFORM THEIR OWN SYSTEMS, AND WILL INCREASE THESE REFORM MEASURES IN THE COMING YEARS. WE DO NOT BELIEVE THAT THE SOLUTION IS FOR THE FEDERAL GOVERNMENT TO CREATE A NEW FEDERAL BUREAUCRACY TO DETERMINE REGULATE AND ENFORCE UNIFORM REPORTING, DISCLOSURE, FIDUCIARY AND ADMINISTRATIVE STANDARDS FOR PUBLIC PENSION PLANS.

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* THE NATIONAL ASSOCIATION OF COUNTIES IS THE ONLY NATIONAL ORGANIZATION REPRESENTING COUNTY GOVERNMENT IN THE UNITED STATES. THROUGH ITS MEMBERSHIP, URBAN, SUBURBAN AND RURAL COUNTIES JOIN TOGETHER TO BUILD EFFECTIVE, RESPONSIVE COUNTY GOVERNMENT.

THE GOALS OF THE ORGANIZATION ARE TO:
- IMPROVE COUNTY GOVERNMENT;
- SERVE AS THE NATIONAL SPOKESMAN FOR COUNTY GOVERNMENT;
- ACT AS A LIAISON BETWEEN THE NATION'S COUNTIES AND OTHER LEVELS OF GOVERNMENT;
- ACHIEVE PUBLIC UNDERSTANDING OF THE ROLE OF COUNTIES IN THE FEDERAL SYSTEM.

NEITHER THE DECIDED TREND TOWARD INCREASED LEGISLATION AND OVERSIGHT AT THE STATE LEVEL NOR THE PROPOSED PERISA LEGISLATION HAS CHANGED ENOUGH TO WARRENT ANY MODIFICATION OF OUR POLICY TOWARD FEDERAL REGULATION OF STATE AND LOCAL GOVERNMENT PENSION PLANS. WE STRONGLY BELIEVE THAT THE STATE GOVERNMENTS ARE IN THE BEST AND MOST APPROPRIATE POSITION TO LEGISLATE, REGULATE AND ENFORCE STATE AND LOCAL GOVERNMENT PENSION POLICIES. THE NATIONAL ASSOCIATION OF COUNTIES AND THE NATIONAL LEAGUE OF CITIES SUPPORT AND ENCOURAGE IMPROVEMENTS IN REPORTING, DISCLOSURE AND FIDUCIARY STANDARDS AT THE STATE GOVERNMENT LEVEL.

WITH INCREASING RESPONSIBILITY FOR THE PROVISION OF GOVERNMENT SERVICES BEING SHIFTED TO THE STATES, COUNTIES AND CITIES THROUGH BLOCK GRANTS, NEW FEDERALISM INITIATIVES AND FEDERAL DEREGULATION IT STRIKES US AS VERY ODD THAT THESE LEVELS OF GOVERNMENT HAVE BEEN DEEMED CAPABLE IN THIS REGARD, AND YET WOULD BE JUDGED INCAPABLE OF REGULATING AND ADMINISTERING THEIR OWN BASIC PENSION SYSTEMS BY CONGRESS. ON THE ONE HAND WE ARE BEING TOLD THAT WE ARE READY TO ASSUME FULL RESPONSIBILITY FOR SUCH DIVERSE AND MAJOR SOCIETAL NEEDS AS WELFARE, FOOD STAMPS, EDUCATION, TRANSPORTATION AND SOCIAL SERVICES, AND YET WE ARE UNEQUIPPED TO HANDLE A BASIC EMPLOYER FUNCTION - PENSIONS.

II. NACO AND NLC POLICY

THE NATIONAL ASSOCIATION OF COUNTIES AND THE NATIONAL LEAGUE OF CITIES HAVE LONG-STANDING POLICY ENCOURAGING PENSION REFORM AT THE STATE AND LOCAL LEVEL. IN ADDITION OUR ORGANIZATIONS HAVE HELD NUMEROUS TRAINING SESSIONS, WORKSHOPS AND POLICY DISCUSSIONS ON PENSION REFORM. IN 1980 WE COMPLETED A JOINT NLC-NACO HANDBOOK, "PENSION ISSUES FOR LOCAL POLICYMAKERS."

NACO POLICY AS EMBODIED IN THE AMERICAN COUNTY PLATFORM IS:

> PUBLIC PENSION PLANS REPRESENT AN INCREASINGLY SIGNIFICANT FACTOR IN THE MANAGEMENT OF COUNTY GOVERNMENTS. NACO SUPPORTS FULL DISCLOSURE AND REASONABLE REPORTING OF INFORMATION REGARDING PUBLIC PENSION PLANS, STRONG FIDUCIARY STANDARDS, PRUDENT INVESTMENT PRACTICES, SOUND FUNDING, AND EQUITABLE VESTING REQUIREMENTS.

PUBLIC PENSION PLANS, THEIR FUNDING, BENEFIT LEVELS, AND THEIR MANAGEMENT REPRESENT A SERIES OF COMPLICATED POLICY CHOICES ARRIVED AT BY ELECTED PUBLIC OFFICIALS. THE DECISIONS NOT ONLY INVOLVE FISCAL CONSIDERATIONS, BUT LABOR-MANAGEMENT DECISIONS AS WELL. PUBLIC PENSION PLANS ARE AN INTEGRAL FUNCTION OF COUNTY, MUNICIPAL, AND STATE GOVERNMENTS. NACO OPPOSES FEDERAL INTERFERENCE WITH THIS IMPORTANT FUNCTION BECAUSE FEDERAL REGULATION THREATENS THE ABILITY OF LOCAL ELECTED OFFICIALS TO CARRY OUT MANDATES GIVEN TO THEM THROUGH THE ELECTORAL PROCESS.

THE NATIONAL LEAGUE OF CITIES POLICY IS EQUALLY PROGRESSIVE AND RESPONSIBLE:

THE PRIMARY RESPONSIBILITY FOR REGULATING MUNICIPAL PENSION PLANS RESTS WITH EITHER STATE OR LOCAL GOVERNMENT. THE FEDERAL GOVERNMENT SHOULD NOT ATTEMPT TO REGULATE SUCH PLANS, EITHER BY LEGISLATION OR BY REGULATION.

IT IS RECOGNIZED, HOWEVER, THAT STATE AND LOCAL GOVERNMENTS, IN THE ORDERLY DISCHARGE OF THESE RESPONSIBILITIES, SHOULD OBSERVE THE FOLLOWING POLICIES:

A. PROVIDE FOR REALISTIC AND EQUITABLE LEVELS FOR RETIREMENT, SURVIVORS, AND DISABILITY BENEFITS ...

B. APPROPRIATE AND TIMELY REPORTING OF THE PENSION SYSTEM'S FINANCIAL CONDITIONS TO PLAN PARTICIPANTS, ELECTED OFFICIALS, TAXPAYERS, AND OTHER INTERESTED PARTIES ...

C. ESTABLISHMENT OF A FINANCING PLAN TO ASSURE ADEQUATE FUNDING OF FUTURE BENEFIT OBLIGATIONS AS THEY ARE EARNED AND ACCRUED AND TO AMORTIZE ACCRUED UNFUNDED LIABILITIES ...

D. ESTABLISHMENT OF FIDUCIARY STANDARDS ...

III. SUMMARY ISSUES

WE SUBMIT THE FOLLOWING FACTS AND CONDITIONS WHICH WE BELIEVE ARGUE OVERWHELMINGLY AGAINST THE NEED FOR AND DESIRABILITY OF FEDERAL PERISA LEGISLATION:

1. STATE AND LOCAL GOVERNMENT PENSIONS ARE PART OF THE BASIC AND INTEGRAL PERSONNEL AND COMPENSATION FUNCTIONS OF THOSE LEVELS OF GOVERNMENT AND THUS SHOULD BE REGULATED BY THOSE LEVELS OF GOVERNMENT.

2. OVER NINETY PERCENT OF STATE AND LOCAL GOVERNMENT EMPLOYEES ARE COVERED BY PENSION PROGRAMS AND THE VAST MAJORITY OF THESE ARE MEMBERS OF LARGE OR STATEWIDE PENSION SYSTEMS WHICH ARE GENERALLY WELL ADMINISTERED AND FUNDED.

3. STATE LEGISLATURES HAVE TAKEN GIANT STRIDES IN THE PAST FEW YEARS TO SET UP PENSION COMMITTEES AND TASK FORCES AND TO REFORM AND CONSOLIDATE PENSION SYSTEMS IN THEIR STATES.

4. A MAJOR IMPETUS FOR ERISA LEGISLATION, PRIVATE SECTOR BANKRUPTCIES AND DEFAULTS, SIMPLY DOES NOT EXIST IN THE PUBLIC-SECTOR. TO DATE, THERE HAVE BEEN NO DEFAULTS ON STATE AND LOCAL PENSION OBLIGATIONS OF WHICH WE ARE AWARE.

5. STATE GOVERNMENTS, NOT THE FEDERAL GOVERNMENT, HAVE THE ULTIMATE RESPONSIBILITY FOR PENSION OBLIGATIONS OF THEIR PUBLIC PLANS AND THOSE OF THEIR JURISDICTIONS. THEREFORE, THEY ARE THE MOST APPROPRIATE LEVEL OF GOVERNMENT TO REGULATE STATE AND LOCAL GOVERNMENT PENSIONS.

6. EACH STATE HAS DIVERSE AND UNIQUE CONDITIONS AND RETIREMENT SYSTEMS WHICH WARRANT FLEXIBILITY AND CONTROL AT THE STATE GOVERNMENT LEVEL RATHER THAN ONE UNIFORM SET OF NATIONAL STANDARDS.

7. EVEN LIMITED FEDERAL PERISA LEGISLATION WOULD, OVER TIME, RESULT IN INCREASINGLY STRICT, PERVASIVE AND INFLEXIBLE REGULATIONS AND FEDERAL BUREACRATIC POLICIES.

8. IN ADDITION TO STATE LEGISLATION AND OVERSIGHT, THERE ARE "FREE MARKET" FORCES SUCH AS BOND RATING REVIEWS AND ACCOUNTING STANDARD CERTIFICATIONS WHICH EFFECTIVELY REINFORCE SOUND FUNDING AND GOOD ADMINISTRATION.

9. WE FEAR THAT FEDERAL REGULATION OF STATE AND LOCAL GOVERNMENT PENSIONS WOULD INEVITABLY BE INFLUENCED BY ERISA PROVISIONS AND PRINCIPLES WHICH WOULD

BLUR THE REAL DIFFERENCES BETWEEN PUBLIC AND PRIVATE PENSION PROGRAMS AND THEIR ADMINISTRATION.

10. THE PROPOSED LEGISLATION WOULD ADD A PLETHORA OF NEW REGULATIONS, REQUIREMENTS AND PAPERWORK MANDATES WHICH WOULD INCREASE THE COSTS, BURDENS AND COMPLEXITY OF PENSION ADMINISTRATION FOR STATE AND LOCAL GOVERNMENTS.

11. THE PROPOSED LEGISLATION MAY BE UNCONSTITUTIONAL BASED ON THE NATIONAL LEAGUE OF CITIES V. USERY SUPREME COURT DECISION, AND CLEARLY VIOLATES THE SPIRIT OF THAT DECISION REGARDLESS.

12. THERE IS NO COMPELLING NATIONAL INTEREST OR NATIONAL CRISIS WHICH WARRANTS FEDERAL INTERVENTION IN THE STATE AND LOCAL GOVERNMENT OVERSIGHT, REGULATION AND ADMINISTRATION OF THEIR PENSION PLANS.

IV. THE FEDERAL ROLE

WE SUGGEST THAT THE FEDERAL ROLE IN THE AREA OF PUBLIC PENSIONS SHOULD BE TO ASSIST AND ENCOURAGE STATE AND LOCAL GOVERNMENTS IN BETTER STRUCTURING AND MANAGING THEIR OWN PENSION PROGRAMS. WE BELIEVE THAT ROLE COULD BEST AND MOST CONSTRUCTIVELY BE ACCOMPLISHED BY THE ESTABLISHMENT OF SOME VOLUNTARY GUIDELINES TO BE USED BY STATE AND LOCAL GOVERNMENTS IN REVIEWING AND REFORMING THEIR OWN PENSION PLANS. THE METHOD USED IN THE WORKERS' COMPENSATION AREA MIGHT BE A POSSIBLE APPROACH TO SUCH AN ENDEAVOR.

WHATEVER METHOD OR FORUM IS USED SHOULD INVOLVE STATE AND LOCAL GOVERNMENT OFFICIALS THEMSELVES AND SHOULD EMBODY A POSITIVE, ADVISORY PHILOSOPHY IN REACHING A NATIONAL CONSENSUS ON THE BASIC PRINCIPLES OF SOUND PUBLIC PENSION PLAN STRUCTURE AND ADMINISTRATION. EVEN WITHIN THIS CONTEXT, ANY RECOMMENDATIONS MUST BE VOLUNTARY AND RECOGNIZE THE DIVERSE REQUIREMENTS, STRUCTURES AND NEEDS OF STATE AND LCOAL GOVERNMENTS AND THEIR PENSION SYSTEMS.

THE APPROACH EMBODIED IN S.2105 AND S.2106 IS, IN OUR JUDGEMENT, THE WRONG WAY TO AFFECT REFORM IN STATE AND LOCAL GOVERNMENT PENSION PLANS. IT CREATES MORE PROBLEMS THAT IT SOLVES, MISSES THE MARK AS TO THE REAL PROBLEMS OF SOME PLANS, PENALIZES THE MAJORITY OF PLANS WHICH ARE WELL ADMINISTERED, AND OVERSTEPS FEDERAL INTERGOVERNMENTAL RELATIONSHIP AUTHORITY.

V. THE STATE AND LOCAL GOVERNMENT EXPERIENCE

STATE AND LOCAL GOVERNMENT OFFICIALS HAVE SHOWN INCREASING AWARENESS OF AND WILLINGNESS TO DEAL WITH PROBLEMS IN THEIR PENSION SYSTEMS. MUCH PROGRESS HAS BEEN MADE IN THE PAST FEW YEARS TO REFORM AND REVISE PUBLIC PENSION PROGRAMS. INDEED, IT IS VERY MUCH IN THE BEST INTEREST OF PUBLIC OFFICIALS TO ASSURE THAT THEIR PENSION PROGRAMS ARE WELL ADMINISTERED AND SOUNDLY FINANCED. VERY FEW STATE AND LOCAL GOVERNMENT EMPLOYEES ARE NOW COVERED BY "PAY AS YOU GO" PENSION PLANS WHEREAS MOST FEDERAL GOVERNMENT EMPLOYEES ARE COVERED BY SUCH PLANS. STATE AND LOCAL GOVERNMENTS HAVE THE INCREASED INCENTIVE OF BOND RATING COMPANIES WHICH INCREASINGLY SCRUTINIZE PENSION BENEFITS AND FUNDING IN DETERMINING THEIR RATINGS.

ANOTHER INCREASING TREND IN PUBLIC PENSIONS IS THE NON-CONTRIBUTORY PENSION PROGRAM. PUBLIC EMPLOYERS ARE INCREASINGLY PAYING THE FULL SHARE OF THEIR EMPLOYEES PENSION BENEFITS. IT IS DIFFICULT TO ARGUE THAT PUBLIC EMPLOYEES ARE BEING TREATED UNFAIRLY INTHIS RESPECT.

FULL REPORTING AND DISCLOSURE BY PLAN ADMINISTRATORS HAS BECOME THE RULE WITHOUT FEDERAL GOVERNMENT REQUIREMENT. THESE PROCEDURES MAY NOT ALWAYS MEET FULL ERISA REQUIREMENTS, BUT REGARDLESS THERE HAS BEEN A DRAMATIC IMPROVEMENT IN RECENT YEARS. IT IS UNREALISTIC AND UNNECESSARY FOR DIVERSE SYSTEMS IN DIFFERENT STATES TO COMPLY WITH ONE NATIONAL STANDARD WHICH WAS DESIGNED FOR ANOTHER SECTOR OF THE WORK PLACE ALTOGETHER.

IN THE FUNDING AREA, IT IS PARTICULARLY INAPPROPRIATE TO MEASURE PUBLIC PLANS BY ERISA STANDARDS BECAUSE STATE AND LOCAL GOVERNMENTS DO NOT GO OUT OF BUSINESS. EVEN PENSION EXPERTS DO NOT AGREE ON ONE MODEL, PERCENTAGE OR NUMBER OF YEARS OF AMORTIZATION WHICH SHOULD BE REQUIRED IN THE PUBLIC SECTOR. WE CAN PROBABLY ALL AGREE THAT "PAY AS YOU GO" SYSTEMS LIKE THOSE IN THE FEDERAL SECTOR ARE NOT DESIRABLE, HOWEVER COMPLETE FUNDING OF BENEFITS WHICH IS REQUIRED IN PRIVATE SECTOR, IS PROBABLY TOO CONSERVATIVE FOR MANY PUBLIC PLANS BECAUSE IT TIES UP TOO MUCH OF CURRENT TAXPAYERS FUNDS FOR FUTURE BENEFITS.

THE MAJOR ISSUES OF PUBLIC PENSION PLANS - LEVEL AND STRUCTURE OF BENEFITS, BASIS FOR FUNDING, PROTABILITY OF BENEFITS, AND SOCIAL INVESTMENTS - ARE NOT ADDRESSED IN THESE BILLS - NOR SHOULD THEY BE. THESE ISSUES SHOULD BE DECIDED BY THE STATE AND LOCAL GOVERNMENTS THEMSELVES THROUGH THEIR APPROPRIATE PROCESSES. WHAT IS PROVIDED IN THESE BILLS ARE A POTENTIALLY COMPLEX SET OF REGULATIONS WHICH WOULD INTERFERE WITH STATE AND LOCAL GOVERNMENT DECISION-MAKING, BLUR THE REAL DISTINCTIONS BETWEEN PUBLIC AND PRIVATE PLANS, COST THE TAXPAYERS AND STATE AND LOCAL GOVERNMENTS CONSIDERABLE EXPENSE, AND STANDARDIZE REPORTING, DISCLOSURE AND FIDUCIARY PROCEDURES BASED ON FEDERAL GOVERNMENT BUREAUCRATIC DECISIONS.

WE DO NOT ARGUE WITH SPECIFIC PROVISIONS OF THE BILLS ON THEIR OWN MERITS. IN FACT MOST OF THE PROVISIONS MAKE GOOD SENSE IN THEIR OWN CONTEXT. WE DISAGREE WITH THE FUNDAMENTAL APPROACH THAT THE FEDERAL GOVERNMENT SHOULD REGULATE, OVERSEE AND PREEMPT STATE AND LOCAL GOVERNMENT DECISIONS IN THIS FUNDAMENTAL AREA. WE ARE FRANKLY VERY CONCERNED ABOUT CREEPING FEDERAL GOVERNMENT EXPANSION OF AUTHORITY AND REGULATION SHOULD A PERISA BILL BECOME LAW. BASED ON YEARS OF PREVIOUS EXPERIENCE IN A VARIETY OF FEDERAL PROGRAMS, WE DO NOT BELIEVE THAT FEDERAL REGULATIONS AND RULE-MAKERS WILL LIMIT THEMSELVES TO THE LETTER OF THE LAW NOR BE ABLE TO KEEP THE ERISA AND PERISA REQUIREMENTS COMPLETELY SEPARATE.

WHILE WE APPRECIATE SOME OF THE REVISIONS INCLUDED IN S.2105 AND S.2106 BASED ON OUR COMMENTS ON PREVIOUS VERSIONS OF PERISA, WE CAN NOT SUPPORT THE PRESENT VERSIONS FOR THE REASONS OUTLINED ABOVE. THE SAME BASIC PROBLEMS AND PITFALLS EXIST WITH THESE BILLS AS PERTAINED TO PREVIOUS BILLS. WE ARE APPRECIATIVE OF THE GOVERNOR'S CERTIFICATION PROCEDURE PROVIDED IN H.R. 4928, BUT WE ARE STILL SUSPICIOUS THAT FEDERAL REGULATORS WILL NOT ALLOW "SUBSTANTIALLY EQUIVALENT" TO MEAN ANYTHING OTHER THAN "ABSOLUTELY EQUAL." WE BELIEVE THAT MUCH PROGRESS HAS BEEN MADE IN STATE AND LOCAL PENSION PLANS OVER THE PAST FEW YEARS AND MORE WILL FOLLOW. THE STATES SHOULD HAVE THE PRIMARY AUTHORITY TO LEGISLATE AND REGULATE. THE LOCAL GOVERNMENTS SHOULD HAVE OBLIGATION TO ADMINISTER AND FUND THEIR PROGRAMS SOUNDLY. THE FEDERAL GOVERNMENT SHOULD ACT AS AN EXAMPLE OF HOW TO FUND AND OPERATE MODEL PROGRAMS FOR THEIR OWN EMPLOYEES AND PROVIDE ASSISTANCE AND ENCOURAGEMENT TO STATE AND LOCAL GOVERNMENTS

FOR REFORMING THEIR PROGRAMS.

VI. SUMMARY

STATE AND LOCAL GOVERNMENTS SHOULD RETAIN THE BASIC RESPONSIBILITY TO STRUCTURE, MAINTAIN, AND REFORM THEIR OWN PENSION PLANS. WE BELIEVE THAT ALL PARTIES INVOLVED SHOULD ENCOURAGE AND WORK TOWARD BASIC PRINCIPLES FOR THEIR OWN PROGRAMS SUCH AS FULL DISCLOSURE, REASONABLE REPORTING, SOUND FUNDING, STRONG FIDUCIARY STANDARDS, PRUDENT INVESTMENT PRACTICES, PLAN CONSOLIDATION WHERE POSSIBLE, INCREASED PORTABILITY, AND BETTER INTEGRATION WITH SOCIAL SECURITY AND OTHER RELATED SYSTEMS. HOWEVER, THE ULTIMATE DECISIONS IN THESE AND OTHER PUBLIC PENSION AREAS FOR THEIR OWN PLANS MSUT BE MADE BY THE STATE AND LOCAL GOVERNMENT ELECTED OFFICIALS THEMSELVES ACCORDING TO THEIR JUDGEMENT OF THE UNIQUE REALITIES, LIMITATIONS, NEEDS, AND REQUIREMENTS OF THEIR GOVERNMENTS AND IN A FAIR AND EQUITABLE MANNER VIS-A-VIS THEIR EMPLOYEES AND THE TAXPAYERS.

WE BELIEVE THE FEDERAL GOVERNMENT ROLE IN THE PUBLIC PENSIONS VIS-A-VIS STATE AND LOCAL GOVERNMENTS SHOULD BE ONE OF ENCOURAGER FOR REFORM, PROVIDER OF TECHNICAL ASSISTANCE, LEADER IN OPERATING SOULD, REASONABLE PLANS FOR ITS OWN EMPLOYEES, AND CATALYST IN THE DEVELOPMENT OF VOLUNTARY GUIDELINES FOR USE BY STATE AND LOCAL GOVERNMENTS IN RESHAPING THEIR PENSION PROGRAMS.

WE BELIEVE WE SHOULD AND CAN MANAGE OUR EMPLOYEE PENSION PLANS WITHOUT DIRECT FEDERAL INVOLVEMENT, PUBLIC PENSIONS BEING A BASIC, INTEGRAL FUNCTION OF STATE AND LOCAL GOVERNMENTS. WE DO NOT BELIEVE THE TIME HAS COME FOR THE FEDERAL GOVERNMENT TO "SAVE" STATE AND LOCAL OFFICIALS FROM THEMSELVES IN THE AREA OF PENSIONS.

GIVEN THE DECIDED TREND TOWARD INTERNAL IMPROVEMENT AND REFORM AT THE STATE AND LOCAL GOVERNMENT LEVEL AND THE GENERAL FEDERAL POLICY OF RETURNING MORE AUTHORITY AND RESPONSIBILITY FOR GOVERNMENT SERVICES ADN PROGRAMS TO STATE AND LOCAL GOVERNMENTS, IT IS NEITHER APPROPRIATE NOR WISE TO ENACT NEW FEDERAL AUTHORITY AND INCREASED FEDERAL REGULATION OF THIS BASIC STATE AND LOCAL GOVERNMENT FUNCTION.

Senator CHAFEE. Thank you very much, Councilwoman Kreamer.

First, I want to say that I think it is important to have elected officials such as yourself and Senator Clark here and, of course, Mr. Natale, who is close to the scene in Colorado.

What would you think if there was legislation with the requirements that there be a certain amount—if you studied this legislation, it hardly seems to me onerous, nor does it fall into the category that Mr. Natale characterized it, as why should Colorado be penalized? How is Colorado penalized in any way under this legislation?

Frankly, I think you meet all the requirements anyway. I think you said so in your own statement.

Mr. NATALE. Are you asking me to respond to that?

Senator CHAFEE. Yes; suppose we pass this legislation. How would Colorado be penalized?

Mr. NATALE. Senator, I used to be a schoolteacher. This legislation reminds me of the days when I taught school, and you had one recalcitrant student so you kept the whole class after school. You kept the entire class because of the misdeeds of one student.

Now, specifically, how would Colorado be penalized? I do not know that Colorado itself would be penalized except that there would be the additional burdens of conformity, depending upon whether this would be S. 2105 or S. 2106, depending upon the necessity for us to deal with some Federal regulators.

As I pointed out in my testimony, what Congress intends in bills that the Congress adopts frequently is changed as the regulators deal with the execution of those bills. I think the package of regulation that might accompany the passage of this legislation is where we would fear.

Senator CHAFEE. Well, suppose that we had a provision exempting a State which adopted a model law. Let us assume Colorado follows the Federal law anyway in the reporting requirements et cetera—I think you indicated that you biannually give a statement to each of your beneficiaries and so forth. Then the Federal Government would do nothing further, require no more reports, nothing, and let the law be enforced on the State level.

If somebody is upset, they can sue under the State statute. No further reports whatsoever to the Federal Government. What do you say to that?

Mr. NATALE. I think that the promulgation of a model law is already, as Senator Clark pointed out, has already been adopted in the State of Texas. I do not think that any Federal legislation is necessary to adopt model laws.

Senator CHAFEE. Well; I cannot take too long on this. But let me just say that I do not think anybody seriously questions that there are problems—and I do not mean just financial problems—with the municipal and State funds. There are problems of conflicts. There are problems of lack of reporting. There are problems of investing in items that are not in the best interest of the beneficiaries.

I mean, Senator Clark mentioned this. To me the gist of what is being said here by Senator Clark and Councilwoman Kreamer and yourself is: Look, the States are cleaning up their act, why does the Federal Government get involved?

That may be so, but for every virtuous State, be it Colorado, Maryland, or Texas or whomever, there are others out there that are apparently doing nothing. Now, what do we do?

Councilwoman Kreamer says that it is not a national issue. Well, I think it is a national issue if there are abuses in these very, very fundamental part of retirees' future. I would wish and hope that the Federal Government would not be involved, but what are we going to do in the interim? Just say in the interest of the new federalism we will just wash our hands and just hope that good old State X will come along?

Councilwoman, what do you say to that?

Ms. KREAMER. I think that our organizations have been providing leadership and education to the local jurisdictions to encourage them to adopt statewide reforms. We do not see the crisis and we do not see a major problem on the horizon which has been indirectly referred.

We believe that the rate of improvement—perhaps Maryland was 7 years behind Colorado, but we are showing how quickly and effectively we can catch up—is an indication that States are giving attention to this.

Senator CHAFEE. States are. I will acknowledge that. But not at the rate that I think we have come to expect.

Ms. KREAMER. Since there are questions of constitutionality and since we judge this to be a very dangerous precedent to enter the field of regulation in this employer basic function, it may not be worth the Federal Government establishing this Employee Benefits Administration through PERISA if it is at the outset considered to be a measure that will be phased out.

Senator CHAFEE. Well, our time is up. I appreciate your views.

Senator Matsunaga is here. Senator, we welcome you. If you have an opening statement or any questions, we will be delighted to hear them.

Senator MATSUNAGA. Mr. Chairman, I apologize for being late. I will read your statements and reserve my questions at this time.

Senator CHAFEE. Thank you.

Let me ask you this: Do you believe that the prospects of this legislation coming over the horizon have lit a fire under the States and local governments to try and meet some of these very modest goals? This is hardly Big Brother coming in and running your show for you.

Mr. CLARK. I suspect it has had something to do with the States' 'move to put their house in order. But I really think we are way ahead of the Federal Government, which has to be the prime example. I really believe that it may be unconstitutional. This is an employee-employer relationship and a part of compensation. If the Supreme Court said that you could not force us to abide by the minimum-wage law, I suspect that maybe we have a very good case for resisting this.

Senator CHAFEE. I notice in your statement, Senator, that you indicated that this issue was the major one facing the National Conference of State Legislatures this year. I am sorry to hear that, because I think there are so many bigger, more important matters out on the horizon than this modest bill, which solely deals with reporting. It says nothing about the funding levels. It solely generates information—plus puts some restrictions on the loans, that is true, of 5 or 10 percent to the employer. I find that very low-level harassment, if, indeed, it is harassment.

Mr. CLARK. Well, we are united. I just attended a meeting in Nashville Saturday of the Midwest and Southern Conference, which is about half the States, and they all reaffirmed their opposition to it. Their message is that we are getting the job done and the Federal Government has not put their house in order, they do not even know the size of the problem yet. That is the message.

Senator CHAFEE. OK. Fine. Well, thank you all very much for coming. We appreciate it.

The next panel is Mr. Hacking and Representative Spaniola. This panel will be on until 11:30. First, I want to thank Representative Spaniola. As I understand, you drove here from Lansing.

Mr. SPANIOLA. That is right, sir.

Senator CHAFEE. Anybody who drives here from Lansing deserves three cheers, which we hereby accord you.

Mr. SPANIOLA. Well, thank you. It was not all that bad.

Senator CHAFEE. It is not only that you drove here, but you get to drive back, presumably. [Laughter.]

All right, why do we not start with Mr. Hacking, you each have 7 minutes. Go ahead.

STATEMENT OF JAMES M. HACKING, ASSISTANT LEGISLATIVE COUNSEL, NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS, ACCOMPANIED BY STEVE ZALEZNICK, LEGISLATIVE REPRESENTATIVE

Mr. HACKING. Thank you, Mr. Chairman. I am accompanied this morning by Steve Zaleznick, one of our legislative representatives. We are here representing both the National Retired Teachers Association and the American Association of Retired Persons, two organizations which now have a collective membership well in excess of 13 million persons age 55 and over. I will submit the Associations' statement for the record and proceed to summarize.

The associations look upon S. 2105 and S. 2106 as legislative steps in the right direction. Either bill would have our support, although for reasons I will get into later, we prefer S. 2106. Either bill would put into place basic standards for reporting and disclosure and for fiduciary responsibility—standards that would provide guidance for public plan trustees and help prevent the kind of abuses that have been documented in the past.

The information required by the reporting and disclosure provisions of S. 2105 and S. 2106 is, we think, essential for a person planning for retirement and for the taxpayers who are paying the bill. While placing only a very nominal burden on plan sponsors, these requirements should yield large compensating benefits in terms of meaningful public information.

The most significant aspect of S. 2105 and S. 2105, from the point of retirees, however, is the establishment of fiduciary standards to guide public plan trustees. From the retiree's perspective, it is essential that trustees act as prudent men and solely in the interest of plan participants and beneficiaries when investment decisions are being made.

If a plan suffers financial losses because of mismanagement or abuse of proper fiduciary standards, the resources available to pay the benefits or provide cost-of-living adjustments for retirees will obviously be diminished.

Retirees also need the protection of strong fiduciary obligations because they are generally not represented on their plan's board of trustees. Even when they are, fiduciary concerns must guide the collective judgment of trustees.

We certainly do not want to see any repeat of the experience of the New York City retirement systems in the mid-1970's. As I am sure you are well aware, legal safeguards were dismantled to facilitate investments by retirement system fiduciaries of large amounts of assets in securities of the city that were not otherwise marketable. While the use of pension assets helped bail out New York, the security of the benefits of retirees was left in serious jeopardy.

This dangerous situation would be avoided by the passage of S. 2105 or S. 2106 because this legislation establishes clear fiduciary guidelines and sets limits on investments in employer securities and property.

Now, while there are many similarities between S. 2105 and S. 2106, I would say that we prefer the latter bill. The first reason is that S. 2106 would avoid the issue of a single administering agency. We think that single agency concept is a good one, but we would rather see that concept raised in the context of S. 1541, the amendments to ERISA. We do not want to see PERISA legislation held hostage in the debate over the single agency issue.

S. 2105 would allow the Governor of the State to certify that State requirements are substantially equivalent to those of certain provisions of the act, while S. 2106 places this responsibility with the Secretary of Labor. We prefer to see this job assumed by the Secretary of Labor, and for this reason, too, we favor S. 2106.

Finally, as the last reason for preferring S. 2106, the bill seems to set slightly stricter standards for fiduciaries who have knowledge of a breach of another fiduciary's responsibility and stricter standards for transactions between fiduciaries and parties in interest.

That concludes my statement, Mr. Chairman. As I indicated, we would favor either of these bills, although we do prefer S. 2106.

[The statement of Mr. Hacking follows:]

STATEMENT

of the

NATIONAL RETIRED TEACHERS ASSOCIATION

and the

AMERICAN ASSOCIATION OF RETIRED PERSONS

on

PENSION REFORM FOR STATE AND LOCAL

EMPLOYEE RETIREMENT SYSTEMS

before the

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

of the

SENATE COMMITTEE ON FINANCE

UNITED STATES SENATE

March 29, 1982

I. Introduction

The National Retired Teachers Association and the American Association of Retired Persons appreciate the opportunity to testify before the Subcommittee on Savings, Pensions, and Investment Policy about pension reform for state and local employee retirement systems. By sponsoring S. 2105 and S. 2106, we believe that Chairman Chafee has taken a significant step toward improving the retirement security for state and local workers and retirees.

From our experience and from the 1978 Report of the Pension Task Force of the House Committee on Education and Labor on Public Employee Retiree Systems, we have found that present legal mechanisms are inadequate to secure the rights of public pension plan participants. S. 2105 and S. 2106 put into place basic standards for reporting and disclosure and for fiduciary responsibility. These standards would provide guidance for public plan trustees as well as prevent abuse. Although these provisions alone will not guarantee the retirement security of public employees, they are a step in the right direction.

II. Federal Action Is Needed

The information required by the reporting and disclosure provisions of S. 2105 and S. 2106 is essential to a person planning for retirement and to the taxpayers who are paying the bill. While placing only a very nominal burden on the plan sponsors, these requirements should yield large benefits. Employees will have access to key information as will parties concerned about the financial status of the sponsoring jurisdiction. Finally, a very basic concept in pension law will become applicable to state and local workers -- they will be told what is being promised to them as deferred wages.

Perhaps the most significant aspect of S. 2105 and S. 2106 for retirees is the establishment of fiduciary standards to guide public plan trustees. From the retirees' perspective, it is essential that trustees act exclusively in the interest of plan participants when investment decisions are made. If a plan suffers financial losses due to mismanagement and abuse of proper fiduciary standards, the resources available to pay the benefits for retirees will be diminished. Even though a plan may be able to continue its payments to retirees, investment losses make provision of cost-of-living adjustments far less likely. In the current inflationary environment, it is essential that trustees be motivated to seek high-yield and safe investments.

Retirees also need the protection of strong fiduciary obligations because they are generally not represented on their plans' boards of trustees. Even when retirees are on the boards, fiduciary concerns must guide the collective judgment of the trustees. This is particularly important in periods, such as the present, when economic downturns focus attention on the capital pool present in public pension plans. Although this capital can be very useful for the economy, it should not be made available at the expense of retirees.

Our experience in this area is based on the situation which occurred in New York City in the mid-70s. At the time, plan trustees invested in very risky City securities without receiving any protection for plan participants. Our analysis indicated that legal safeguards for participants were contained in the municipal and state codes and possibly in the Internal Revenue Code. Yet these safeguards were taken away by the New York State Legislature and by Congress when a market was sought for the securities.

While the use of pension assets did assist New York City, our Associations were very concerned that retirees were left shouldering a tremendous risk when their safeguards were dismantled. Without these protections, the City plans' trustees could have invested all of the pension assets (including employee contributions) in City securities. This dangerous situation would be avoided by the passage of S. 2105 or S. 2106 because this legislation clearly states fiduciary guidelines as well as limitations on the investment in employer securities.

III. Major Differences Between S. 2105 and S. 2106

While S. 2105 and S. 2106 contain many similarities, there are a number of reasons why we believe S. 2106 is the preferable approach.

S. 2105 would create a single agency to administer the new Public Employee Retirement Income Security Act as well as ERISA, which governs private plans. S. 2106 does not contain a similar provision. The Associations have testified before the Subcommittee on Labor of the Senate Committee on Labor and Human Resources on S. 1541 (the Retirement Income Incentives and Administrative Simplification Act of 1981), which contains a similar provision. While we support the single agency approach, it is probably best obtained in the context of ERISA amendments. Therefore, we would be reluctant to include this issue in the debate regarding public plan reform.

S. 2105 would allow the governor of the state to certify that state requirements are substantially equivalent to those of certain provisions of the Act, while S. 2106 places this responsibility with the Secretary of Labor. We would prefer to see this job maintained by the Secretary of Labor, because there is far more expertise at DOL to judge the efficacy of pension standards than in individual states. Additionally, there could be a good deal of pressure on individual governors to find their state laws in compliance, while the dominant concern for the Secretary of Labor should be the protection of plan participants.

Additionally, S. 2106 appears to set slightly stricter standards for fiduciaries who have knowledge of the breach of another fiduciary's responsibility and for transactions between fiduciaries and parties in interest. We feel that these stricter standards should not present a problem for plan fiduciaries, and they will provide additional protection for plan participants.

The Associations believe that S. 2106 is an appropriate, though limited, response to the present lack of protections for public pension plan participants. Its enactment will help ensure that state and local jurisdictions take the necessary steps to operate their pension plans in the best interest of the plan participants.

Senator CHAFEE. All right, what we will do is we will hold questions until Mr. Spaniola speaks and gives his testimony. I notice you have a formidable statement here, but we will put it all in the record. You may summarize, if you wish, Mr. Spaniola.

STATEMENT OF HON. FRANCIS R. SPANIOLA, CHAIRMAN, HOUSE SENIOR CITIZENS AND RETIREMENT COMMITTEE, MICHIGAN HOUSE OF REPRESENTATIVES, ACCOMPANIED BY DENNIS J. GRETHER, STAFF MEMBER, SENIOR CITIZENS AND RETIREMENT COMMITTEE, MICHIGAN HOUSE OF REPRESENTATIVES

Mr. SPANIOLA. Thank you, Mr. Chairman and Senator Matsunaga. I am Francis R. Spaniola, State representative from the 87th District in the State of Michigan. I am chairman of the standing committee in the Michigan House of Representatives on senior citizens and retirement, and a member of the National Conference of State Legislatures Pension Committee.

I am accompanied by Dennis J. Grether, research analyst and professional staff to the Senior Citizens and Retirement Committee.

We are very pleased to appear before your subcommittee today to present our views on S. 2106, the Public Employee Retirement Income Security Act of 1982, introduced on February 11 by you, Mr. Chairman, which proposes the establishment of reporting, disclosure, and fiduciary responsibility requirements and administrative and enforcement procedures for State and local government pension plans.

For the 3 years that I have been chairman of the House Retirement Committee, I have opposed PERISA. I have argued locally and nationally with my NCSL Pension Committee colleagues and my own colleagues at home that we at the level of State government must put our own pension house in order.

I believed we could educate all of the interested parties about the pension problems and find constructive solutions without the need for PERISA. I tried to convince my legislative colleagues at the NCSL level and at home to point to PERISA and use it as an incentive to speed the process of pension reform at the State and local level.

After 3 years of continuous effort and considerable agony, my goals are the same, but my perspective has changed. While my views may send shock waves throughout the NCSL Pension Committee, and offend my good friend State Senator Paul Hannoway, I stand ready to accept the consequences because I appear here today to vigorously support the enactment of S. 2106.

We believe S. 2106 is a timely and prudent response to the crisis currently facing public pension plans. Plan participants and taxpayers, State and local public pension plans are beseiged with problems which threaten the fiscal stability of the plan, the legal and moral rights of plan members and the financial integrity of the sponsoring unit of government.

Plan benefits are in an irrational patchwork. Many plans are dangerously underfunded. Funding practices represent an avoidance of short-term political pain rather than the adoption of a long-term sound policy. Conflict-of-interest problems abound in the investment of plan assets.

Even in the development or negotiation of plan benefits, no single uniform set of standards for reporting, disclosure, and fiduciary responsibility has been adopted to guide plan managers, participants, or trustees.

We believe that minimum reporting, disclosure, and fiduciary standards must be established for State and local pension plans and that it is the responsibility of the Federal Government to ensure these standards are met.

We concur with both the 1978 Pension Task Force report and the final report of the President's Commission on Pension Policy that State and Federal pension plans are inadequately regulated and that Federal legislation is necessary to protect vital national interests.

We view the reporting and disclosure and fiduciary standards proposed in S. 2106 essential to the protection of plan participants and taxpayers from the mismanagement of plan assets.

We offer three recommendations to strengthen the bill:

One, to the reporting and disclosure requirements we recommend adding the requirement that full disclosure of the short- and long-term fiscal impact of any proposed benefit be made before the benefit be adopted;

Two, to the fiduciary standards we recommend adding the requirement that investments in tax-exempt securities shall be made only at taxable equivalent yields as available in the marketplace on securities of similar risk and maturities.

We oppose the inclusion of the provision of S. 2105 which allows the Governor of a State to certify that State laws are substantially equivalent to the PERISA standard.

We are committed to the creation and adoption of sound public pension policies. We believe the passage of an amended S. 2106 would add immeasurably to our efforts to put our public pension house in order.

As we said to 300-plus Michigan Municipal League members last Thursday, and I quote:

> PERISA should cause you no alarm, unless you do not want to know about your public plans. Your greatest enemy is ignorance caused by the lack of information and the lack of understanding. We think PERISA will do much to help us meet our educational goals.

Thank you, Mr. Chairman, and you, Senator Matsunaga, for the opportunity to present this statement. We look forward to continuing to work with you on this matter of utmost importance to the participants in State and local plans. We will be pleased to answer any questions you might have.

[The statement of Mr. Spaniola follows:]

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EDUCATION
SOCIAL SERVICES
TOWNS & COUNTIES
PUBLIC SAFETY

STATEMENT BY

FRANCIS R. SPANIOLA

STATE REPRESENTATIVE

87TH DISTRICT

CORUNNA, MICHIGAN

BEFORE THE

UNITED STATES SENATE SUBCOMMITTEE

ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

ON

S.2106

THE PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1982

MARCH 29, 1982

WASHINGTON, D.C.

Mr. Chairman and distinguished members of the Subcommittee on Savings, Pensions, and Investment Policy, I am Francis R. Spaniola, State Representative from the 87th District in the State of Michigan. I am Chairman of the standing committee in the Michigan House of Representatives on Senior Citizens and Retirement and a member of the National Conference of State Legislatures' Pension Committee. I am accompanied by Dennis J. Grether, Research Analyst and Professional Staff to the Senior Citizens and Retirement Committee.

We are very pleased to appear before your Subcommittee today to present our views on S.2106, the Public Employee Retirement Income Security Act of 1982 (PERISA), introduced on February 11 by Senator Chaffee, which proposes the establishment of reporting, disclosure and fiduciary responsibility requirements and administrative and enforcement procedures for state and local government pension plans.

For the three years that I have been Chairman of the House Retirement Committee, I have opposed PERISA. I have argued locally and nationally with my NCSL Pension Committee colleagues that we, at the level of state government, must put our own pension house in order. I believed we could educate all the interested parties about the pension problems and find constructive solutions without the need for PERISA. I tried to convince my legislative colleagues in NCSL to point to PERISA and use it as an incentive to speed the process of pension reform at the state and local level.

After three years of continuous effort and considerable agony, my goals are the same but my perspective has changed. While my views may send shock waves throughout the NCSL Pension Committee, I stand ready to accept the consequences because I appear here today to vigorously support the enactment of S.2106.

We believe S.2106 is a timely and prudent response to the crisis currently facing public pension plans, plan participants, and taxpayers. State and local public pension plans are besieged with problems which threaten the fiscal stability of the plan, the legal and moral rights of plan members, and the financial integrity of the sponsoring unit of government. Plan benefits are an irrational patchwork and many plans are dangerously underfunded. Both benefit design and funding practices represent an avoidance of short-term political pain rather than the adoption of a long-term sound policy. Conflict-of-interest problems abound in the investment of plan assets, and even in the development or negotiation of plan benefits. No single uniform set of standards for reporting, disclosure and fiduciary responsibility has been adopted to guide plan managers, participants, or trustees.

We believe that minimum reporting, disclosure and fiduciary standards must be established for state and local pension plans and that it is the responsibility of the Federal Government to insure the standards are met. We concur with both the 1978 Pension Task Force Report and the final report of the President's Commission on Pension Policy that state and federal pension plans are inadequately regulated and that federal legislation is necessary to protect vital national interests. We view the reporting, disclosure, and fiduciary standards proposed in S.2106 essential to the protection of plan participants and taxpayers from the mismanagement of plan assets. An expanded statement of our reasons for supporting S.2106 follows, along with some examples from our own experience in Michigan reinforcing the need for S.2106. Finally, we offer three recommendations to strengthen S.2106.

I. REPORTING AND DISCLOSURE OF PLAN INFORMATION: A CRITICAL ELEMENT TO OUR EFFORTS TO REFORM LOCAL PENSION POLICIES

Regular and orderly disclosure of information about our public pension plans is the key to our efforts to educate ourselves and others about public plans. Without the plan information, we are missing the basic building block to meet our educational goals. We may never learn if our pension policies are sound and reasonable without full reporting and disclosure. By the time we learn our policies have been irresponsible, the public officials who created the policy have left office, leaving behind two groups of victims--plan members and taxpayers. By no action of their own, members may be denied pensions they have already earned; taxpayers may be saddled with tax burdens wholly unfair and inequitable.

Some legislatures have taken action to try to educate themselves about pension problems. In late 1980, Michigan joined twenty-odd states who have created pension commissions when a bill I authored was signed into law as Public Act 520 of 1980 (see Attachment #1). A few days later, I publicly opposed an unconscionable pension sweetener that my legislative colleagues tried to ram through for themselves in the lame-duck session following the November election. It is no coincidence that my legislative colleagues have not seen fit either to fund the pension council or appoint membership. A stillborn council cannot advise the Legislature on pension policies for which they want no advice!

A few of my legislative colleagues see this stillborn child as punishment for my independent behavior, my unwillingness to "go along." Tragically, they do not realize the damage they may be doing to many other pension plan members by denying them the policy advice this council could render. They may even be contributing to their own demise, and mine, as well. The anti-government demagogue from my county who is to Michigan what Jarvis was to California now has a new petition for the November ballot. He proposes to cut our Legislature from full-time back to a 90-day session, and eliminate the Legislative Retirement System! A preference for ignorance may be self-destructive.

The headlines of a January 29, 1982 Detroit Free Press article (see Attachment #2) proclaimed: "BROKE SUBURB SUSPENDS POLICE, FIRE PENSIONS." The Mayor of Highland Park, Michigan informed 187 retired police officers and firefighters that they would have to sue to collect their pensions. Conceding that the state constitution requires the city to make the pension payments, the mayor said, "I just don't have the money."

Would the existence of the pension council have prevented this tragedy? Would full reporting and disclosure of financial condition of the plan, a la PERISA, have saved 187 victims in Highland Park from the irresponsible policies of public officials?

Does it help us to fix blame in this instance? The city has obviously known about this financial timebomb for a long time. To quote the mayor again, "This is a day that has been coming that everyone anticipated." By his own admission, the mayor acknowledges that neither he nor his colleagues in public office could resist the temptation of irresponsible funding policies. In fact, the city has been giving both the police and fire and the general employees plan IOUs instead of real money since 1970. It only took roughly 12 years of the pay-as-you-go policy before it claimed 187 retirees as victims. If the policy continues, the retirees of the general plan will be next.

This is not an isolated case. Detroit's old police and fire plan was identical to the Highland Park benefit plan with pension amounts tied to the salaries of current workers. Both Highland Park and Detroit capped the unlimited escalator at 2% per year in 1970 but Detroit continued to fund the plan. The neighboring city of Hamtramck had the same benefit escalator but they closed the plan altogether in 1970. Clearly, some public officials can act in a rational manner if the consequences of irresponsible policies are understood. This only reinforces the need for regular and comprehensive reports on the actuarial condition, the financial and accounting principles in use, and a clear description of benefit coverage for plan members. These are critical to be able to assess the strength and weakness of a system. Without these reports, our efforts to educate the members so they can hold public officials accountable will be for naught.

S.2106 could be strengthened in the area of disclosure, particularly as the disclosure of information assures an equitable tax burden for current and future taxpayers. WE RECOMMEND THAT S.2106 REQUIRE THE DISCLOSURE OF FISCAL IMPLICATIONS FOR ANY BENEFIT IN A PUBLIC FORUM BEFORE THE BENEFIT COULD BE ADOPTED. By comparison, the disclosure requirements for any new bonded indebtedness are very stringent. Bond disclosure requirements include a thorough review of the current financial condition, a projection of revenues, and the economic assumptions behind the projections. The disclosure seeks to assure everyone that the new debt can be retired without default. It serves to display what the tax burden will be for current and future taxpayers so the money will be there when the debt comes due. Since the costs of future pension liabilities can be spread over taxpayers as far into the future as infinity (using the "interest only" method), how can we justify disclosure requirements less thorough for pension obligations than for sewers?

II. UNIFORM FIDUCIARY STANDARDS ARE ESSENTIAL TO PROTECT PLAN MEMBERS.

Public plans, with assets valued in excess of $200 billion, represent one of the largest blocks of invested capital in the financial marketplace. In Michigan, our 200 public plans have assets representing 5% of this total, or roughly $10 billion. In normal economic times, many public officials with expansive ideas cast furtive eyes on this huge block of capital. In these times of severe economic and fiscal stress, almost everyone looks to the pension assets as the solution to many economic problems.

Michigan has a long history of manipulating both accounting and actuarial techniques to solve a short-term budget problem. The manipulations have always resulted in either deferring costs further into the future, or in acquiring "interest-free" loans from the pension plans.

In 1975, Michigan was in the depths of a recession. The administration extended the fiscal year to 15 months in order to capture 3 months' worth of tax revenues. We also consolidated the administration of the Detroit School Retirement System with the outstate system in one central location in Lansing. In the consolidation, the Governor's Budget Director "found" $34.6 million in a contingency fund in the Detroit School Retirement System. The funds represented earnings on investments which exceeded pension payouts and which had not been transferred into an account to cover future pension obligations. Dr. Miller, the budget wizard, transferred the entire sum to the outstate teachers retirement fund and subsequently reduced the burden on the state's general fund for the same year by $34.6 million! I believe ERISA would prohibit realizing all of those actuarial gains in one year.

In 1977, a group of retired school employees took the same Budget Director, the State Treasurer, the Board of Trustees and others to court. The retirees, still angry about the $34.6 million, charged that the state had violated the provision of the 1963 Constitution which prohibits the use of current service contributions to pay unfunded past service liabilities. An actuary hired by the plaintiffs estimated that $450+ million of post-1963 current service contributions had been used to meet the pre-1963 unfunded liabilities of pension payrolls paid between 1975 and 1977.

The case the retirees had against the state looked very solid and both the Governor and legislative leaders were worried. Before the State Supreme Court could decide the case, the Governor's budget chief convinced a willing Legislature to change the actuarial method by which the service was valued from the attained-age method to the entry-age method. With passage of Public Act 275 of 1977, the entry-age method of valuing service was adopted and applied RETROACTIVELY to 1963! This action effectively reallocated $460 million of current service contributions to unfunded past service liabilities, thereby legalizing the pension payouts which had already occurred. The retroactive application of this change in actuarial methods would have been a violation of ERISA.

The retirees' case (Kosa v Board of Trustees, et al.) never had a chance after the passage of PA 275. When the Supreme Court finally decided the case in 1980, it ruled that the pension payouts from current service contributions had been illegal. However, the Legislature had "remedied" the situation with PA 275. When the retirees sought to have the state pay back the $460 million in accordance with the existing 50-year amortization schedule in the retirement statute, the state's attorneys laughed up their collective sleeves at the thought of paying $30 million per year for a total of $1.5 billion. When the Supreme Court ruled that it could not order the Legislature to appropriate the money, the retirees settled out of court for $190,000.

Other instances of "interest-free" loans have occurred in the continuous battle over proper funding levels. Shortly after becoming Chairman of the Retirement Committee, I learned that the same Director of the Department of Budget and (Mis)Management had been undercontributing to the State Employees Retirement System. By overestimating future payrolls and underwithholding from actual payrolls, Dr. Miller had systematically underfunded the system to the tune of $100 million between 1975 and 1979. When confronted with the information which conclusively demonstrated the 4-year violation of legal funding requirements, Dr. Miller told my committee that the law should be changed. He opposed the 50-year amortization schedule for unfunded liabilities and preferred the "modified interest only" method in which the unfunded values rise along with payrolls. Each year since 1979, we have battled over the same issue. To this day, he continues to withhold at the "modified interest only" level even though the law requires a 50-year amortization schedule.

Most recently, the high rates of inflation over the past several years and the parallel high rates of interest have combined to produce similar high rates of yield on the invested pension assets. With Michigan in the third year of a near depression, the plunging tax revenues have squeezed all of the life out of our general fund budget. The Governor proposed to "save" $100 million in the current fiscal year by raising the economic assumptions used in the pension plans (see Attachment #3). By assuming the investments will average an 8% return into the distant future (up from 6%), and taking those future investment returns into account before they occur, the state was able to lower its current contribution to the two major retirement systems by nearly $100 million. Since the money had already been appropriated to the two systems, plan members were treated to a new version of an "interest-free" loan. If their letters to me are indicative, their confidence and trust in the management of their retirement systems has sunk even lower.

We recognize that the fiduciary standards as proposed in PERISA do not regulate funding schedules. We concur with the NCSL position which opposes the federal imposition of funding schedules. However, it is important to note how closely associated the fiduciary standards of PERISA are to the funding practices in the public plan arena.

We began working on rewriting the fiduciary standards governing the investment of public pension funds in Michigan almost three years ago. Our initial efforts were associated with a bill I sponsored to bring the investment statute into the late 20th century, giving the investment fidicuaries more flexibility in structuring the investment portfolio. Before we could begin serious committee work on the bill, a Chrysler drove into our lives.

The Governor proposed to make a $150-million mortgage loan to Chrysler using its sprawling headquarters in Highland Park (!?) as collateral. Upon reviewing the Governor's proposal, the value of the collateral seemed woefully inadequate to support a $150-million loan. When the same group of retired school employees who sued the state had the temerity to question the reasonableness of the proposal, the Governor said he would make the loan.

We wrote to the Governor (see Attachment #4) expressing our concern for his proposal and his insistence that the loan was a prudent investment of pension assets. The ensuing six months led us into the thicket of financial matters beyond what either of us had ever experienced before. Our goal was to insure the prudence of any loan made from pension assets. The Governor's goal was to save jobs in Michigan and keep Chrysler from closing its doors.

When the Chrysler Loan Guarantee Act required approximately $250 million in help from various states, our goal was to write the Chrysler loan bill in such a manner that the public assets of the state were protected. We wanted to insure that the fiduciaries, rather than the politicians, made the final decision on which funds should be used to make the loan. The Investment Advisory Committee, the oversight fiduciaries for the state pension funds, would not support the investment of public pension assets in a Chrysler mortgage loan. In the end, the state's general fund made a $150-million loan to Chrysler, taking a mortgage on the firm's newest engine plant as collateral. The loan was made at market rates.

Building on the knowledge we gained from the Chrysler experience, we again took up the task of rewriting the law governing public pension assets. As we began working with the State Treasurer and the 200+ local plans across the state, the City of Detroit began to show signs of severe fiscal distress. A special fiscal review committee was formed to assess the city's condition and offer solutions. Named after a Ford Motor Company vice-president, the Secrest Committee performed a function for Detroit similar to that done by the Shinn Committee for New York City in 1975. The final report was used with great effectiveness by Mayor Coleman Young to convince the Legislature to pass a special income tax increase for the city. The basic battle cry from the city's supporters was, "Let us help ourselves."

The Detroit package of legislation included a bill which would have allowed public pension funds to purchase special deficit financing bonds which were created by another bill in the package. Drafted with the New York City experience in mind, the pension bill asserted the bonds were a prudent investment and offered the fiduciaries forgiveness from any personal liabilities. We rewrote the bill, eliminating the forgiveness language and requiring any deficit financing bonds purchased by fiduciaries to yield a rate of return to the pension funds equal to the rate the funds would have earned if corporate bonds of similar risk and maturity would have been purchased at the same time.

The city officials objected strenuously to our substitute bill. They approached the State Treasurer to explore the possibility that he would be willing to purchase some of the bonds under existing statutory authority. To his credit, the State Treasurer quoted the same city officials an interest rate for their bonds which was a taxable equivalent yield. Again, the city officials and their legislative representatives thought the rate was outrageous. Finally, the city negotiated a private placement of $113 million of the deficit finance bonds--$56.5 million with a consortium of local banks and $56.5 million with the two city pension funds. The interest rate on the bonds was 13%, a full 4% below the taxable equivalent yield the State Treasurer had quoted to the city a few weeks earlier. The city used the money to make overdue payments to the same two pension funds.

In the context of fiduciary standards, we were very concerned about the structure of the deal. In a letter to the Detroit Free Press dated August 10, 1981, which the paper chose not to print, we laid out our concerns (see Attachment #5). The Detroit Police and Fire pension plan, having capped its unlimited escalator at 2% per year a decade earlier, was still funded on an unsound actuarial basis. A Firefighters fund in New York

City which was similarly funded in 1975 was not required to purchase any of the so-called "Big Mac" bonds. Yet, the Detroit Police and Fire plan, over the protests of some of its trustees, voted to support the mayor and purchased one-half of the $56.5 million at the below market rate.

It is significant to note that Detroit did not seek, nor was it offered, the same federal protection as New York City. The special legislation enacted by Congress to protect the New York trustees and to guarantee the bonds was not there for Detroit. It required the efforts of many concerned parties to convince the city to approach the Internal Revenue Service to inquire if the deal would jeopardize the qualified status of the plans. Some time later, an individual within the IRS sent a private letter to Detroit's Finance Director apparently offering the IRS blessing to the deal. Most of us who have read the IRS letter take no comfort from it whatsoever. We offer the observation of Dr. Roy Schotland, law professor from Georgetown (see Attachment #7), as a capsule summary of the Detroit deal: "Either it's a gift to the banks, or a rip-off of the funds." He opined it was "a rip-off of the funds."

S.2106 should be strengthened in the area of fiduciary standards relative to the investment of pension funds. The rationale in the IRS letter clearly permits governmental units to borrow from their own plans. If you push the logic to the extreme, the more troublesome the fiscal circumstances in which the governmental unit finds itself, the more appropriate it is for it to borrow from its own plans. If the fund loans plan assets to the sponsoring unit of government at below-market rates, the deal simply hides an increased tax burden for future taxpayers. These "lost" interest earnings will show up in the unfunded liabilities of the plan and the plan will be actuarially weakened for having made the loan.

We support the 5% limit on the purchase of employer's securities in S.2106. WE RECOMMEND ADDING TO THE FIDUCIARY STANDARDS FOR THE INVESTMENT OF PENSION FUNDS THE REQUIREMENT THAT INVESTMENT IN TAX-EXEMPT SECURITIES SHALL BE MADE ONLY AT TAXABLE-EQUIVALENT YIELDS AVAILABLE IN THE MARKETPLACE AT THE TIME THE INVESTMENT IS MADE. By the addition of this protection, the possible actuarial deterioration due to such investments will be eliminated. Hidden tax burdens will be avoided. Finally, the taxable-equivalent yield closes the backdoor to the imposition of future funding requirements.

III. THE INTERESTS OF PLAN PARTICIPANTS ARE NOT FULLY PROTECTED.

The Michigan Legislature completed final work on my bill rewriting the investment statute for public pension funds only last Thursday. It includes the PERISA fiduciary standards strengthened by the taxable equivalent yield requirement. The bill also offers local plan fiduciaries a signpost directing them to the State Treasurer for questions regarding the fiduciary standards, permitted investments, the budgeting and accounting requirements of our local uniform budgeting act. To this extent, we have done what is possible to aid the local pension plans. It is not enough.

S.2106 should be strengthened to further protect the interests of plan participants. WE RECOMMEND THE AUTOMATIC QUALIFICATION AS SET FORTH IN S.2105 BE INCLUDED IN S.2106. If the states meet the test of substantial equivalence, then we believe the plans should be automatically qualified. The financial risk associated with loss of qualified status is too great, particularly given the checkered history of IRS enforcement. The IRS letter to Detroit only reinforces our concern in this matter. Finally, WE OPPOSE THE PROVISION OF S.2105 WHICH PERMITS THE GOVERNOR OF A STATE TO CERTIFY THAT STATE LAWS ARE SUBSTANTIALLY EQUIVALENT TO PERISA STANDARDS. Our own experience in Michigan has taught us not to rely on the judgment of our Governor as to what is prudent. Like any other elected official, he can be moved more by the avoidance of short-term political pain than by the need to fulfill a long-term prudent goal.

CONCLUSION

We are committed to the creation and adoption of sound public pension policies. We believe the passage of an amended S.2106 would add immeasurably to our efforts to put our public pension house in order. As we said to 300+ Municipal League members last Thursday, "PERISA should cause you no alarm, unless you do not want to know about your public plans. Your greatest enemy is ignorance--caused by the lack of information and the lack of understanding." We think PERISA will do much to help us meet our educational goals.

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 importance to the participants in state and local plans. We will be pleased to answer any questions you may have.

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3/26/82

ATTACHMENT #1

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JAN 26 1981

STATE OF MICHIGAN

80TH LEGISLATURE

REGULAR SESSION OF 1980

Introduced by Reps. Spaniola, Lincoln, Thomas H. Brown, Burkhalter, Richard A. Young, McCollough, Padden, Bennane, Hollister, Alley, Trim, Mary C. Brown, Rocca, Maynard, Dutko, Bullard, Hertel, Andrews, Lalonde, Bennett, Sietsema, Cushingberry, Clodfelter, Vanek, Dongvillo, Vaughn, Griffin, Hasper, Jondahl, Evans, Collins, Scott, Watkins, Joe Young, Jr., Harrison, Fitzpatrick, Kirksey, Keith, Tomboulian, Law, Ciaramitaro, Barcia, Symons, Legel and Wilson

ENROLLED HOUSE BILL No. 4458

AN ACT to create a council on public employee retirement systems and to prescribe its powers and duties; and to prescribe powers and duties of the legislative council and the legislature with respect to public employees retirement systems.

The People of the State of Michigan enact:

Sec. 1. As used in this act, "council" means the council on public employee retirement systems created by section 2.

Sec. 2. (1) A council on public employee retirement systems is created within the legislative council to consist of 7 members appointed by the legislative council. Not less than 5 members shall have experience in the fields of pensions, investments, actuarial science, pension law, or governmental finance. However, not less than 2 of those members with experience in the fields designated by this section shall have experience in the field of actuarial science. Two active, inactive, or deferred members or retirants of a public employee retirement system of this state shall be members of the council.

(2) The term of a member appointed, except to fill a vacancy occurring other than by expiration of term, shall be 4 years from the expiration of the term of the member's predecessor. However, the terms of the members first appointed shall be as follows: 1 shall be appointed for 1 year, 2 for 2 years, 2 for 3 years, and 2 for 4 years. A vacancy in the office of an appointed member occuring other than by expiration of term shall be filled in the same manner as the original appointment for the balance of the term.

(3) The legislative council shall designate 1 of the appointed members as chairperson of the council. The council shall meet at the call of the chairperson, but not less than 4 times per year.

(4) The per diem compensation of the council and the schedule for reimbursement of expenses shall be established annually by the legislature.

Sec. 3. (1) The business which the council may perform shall be conducted at a public meeting of the council held in compliance with Act No. 267 of the Public Acts of 1976, as amended, being sections 15.261 to 15.275 of the Michigan Compiled Laws. Public notice of the time, date, and place of the meeting shall be given in the manner required by Act No. 267 of the Public Acts of 1976, as amended.

(2) A writing prepared, owned, used, in the possession of, or retained by the council in the performance of an official function shall be made available to the public in compliance with Act No. 442 of the Public Acts of 1976, as amended, being sections 15.231 to 15.246 of the Michigan Compiled Laws; except that individual member data provided to the council by a public employee retirement system or by a public employee is exempt from disclosure under this subsection.

Sec. 4. (1) The council shall appoint an executive director who, with the approval of the council, may appoint other employees, engage consultants, and retain actuaries as needed, prescribe their duties, and fix their compensation within the amount appropriated for the council.

(2) The executive director shall perform those duties required by the council to implement this act.

Sec. 5. (1) The council shall be established in 2 stages, a developmental stage beginning with the appointment of the full council and lasting 6 months followed by an operational stage. During the developmental stage, the council:

(a) Shall develop procedures and principles for a continuing review of all public employee retirement systems, including recommended changes and amendments to the systems, coordination of system benefits, and an appropriate financing method.

(b) Shall develop procedures and principles for evaluating all proposed legislation related to pension issues. The procedures and principles shall provide for comments on the need for the legislation, cost, and the implications for future policy.

(c) Shall develop procedures and principles for reviewing and commenting on all audits, actuarial valuations, reports, and other data pertaining to public employee retirement systems

(d) Shall develop a plan and begin to gather, catalog, and maintain complete information on all public employee retirement systems in the state based on a review of audits, reports, and other data pertaining to these systems.

(e) Shall formulate principles and objectives related to income after retirement, disability and death benefits, social security benefits, and other retirement needs of public employees.

(f) Within 2 months after the end of the developmental stage, shall present a report to the legislature and governor detailing the results of subdivisions (a) to (e).

(2) During the operational stage, the council:

(a) Shall conduct a continuing review of all public employee retirement systems according to the procedures and principles developed pursuant to subsection (1)(a).

(b) Shall evaluate and make recommendations in a written report to the legislature on all legislation related to pension issues according to the procedures and principles established pursuant to subsection (1)(b). The council shall respond to requests from the legislature or a standing committee responsible for the consideration of retirement legislation in each house for the written reports in a timely manner.

(c) Shall review and may comment upon audits, actuarial valuations, and reports according to the procedures and principles established pursuant to subsection (1)(c).

(d) Shall continue gathering, cataloging, and maintaining information on public employee retirement systems according to the plan developed pursuant to subsection (1)(d).

(e) Shall conduct studies of income after retirement, disability and death benefits, social security benefits, and other retirement needs of public employees according to the principles and objectives established pursuant to subsection (1)(e). Studies may be initiated by an action of the standing committee in either house of the legislature responsible for retirement legislation.

(f) Shall cooperate with various state and local retirement boards on matters of mutual concern.

(g) Shall submit an annual budget and a plan for the general activities of the council to the legislature.

(h) Shall issue an annual report to the legislature and the governor citing the activities, findings, and recommendations of the council. The council may include proposed legislation to carry out the council's recommendations. Any legislation proposed by the council shall be submitted to the joint review committee created by section 7.

(i) Shall be limited to an advisory and information function only.

(j) May provide technical assistance to local units of government in the assessment and revision of their public employee retirement systems.

(k) May contract to conduct retirement studies for local units of government or for other entities.

(*l*) May seek and accept grants.

(m) May study the relationship of public retirement policy to other aspects of personnel policy and to the effective operation of government generally.

(n) For the purpose of carrying out its powers and duties, may subpoena witnesses upon approval of the legislature, review books and records, hold public hearings, and take testimony. A witness summoned to a hearing shall have the right to be accompanied by legal counsel.

(3) The council from time to time may change the procedures established in subsection (1)(a) to (e) and

shall report those changes to the legislative council and the standing committee in each house of the legislature responsible for retirement legislation.

Sec. 6. The council may establish 1 or more advisory committees to advise the council concerning a public employee retirement system, including the benefits, actuarial projections, and financial liabilities of the system to this state or a local unit of government.

Sec. 7. (1) The legislature shall create a joint review committee composed of 5 members of each house who serve in their respective houses on standing committees responsible for the consideration of retirement legislation. The members shall be appointed in the same manner as members are appointed to standing committees in each house. The joint review committee shall initiate a review of the functions, responsibilities, and performance of the council not later than February 1, 1986.

(2) The joint review committee shall report to the legislature not later than September 30, 1986, recommending continuation, termination, or alteration of the council.

Sec. 8. This act shall expire September 30, 1986.

T. Thos. Thatcher
....
Clerk of the House of Representatives.

William C. Kandler
....
Secretary of the Senate.

Approved ....

....
Governor.

ATTACHMENT #2

Detroit Free Press

Section A, Page 3 SECOND FRONT PAGE Friday, January 29, 1982

today's chuckle
When the child heard the story of Cinderella, he asked: "When the pumpkin turns into a golden coach, is that regarded as straight income or capital gains?"

Broke suburb suspends police, fire pensions

Highland Park retirees vow a fight

By THOMAS BEVIER
Free Press Staff Writer

Highland Park Mayor Robert Blackwell told retired police officers and fire fighters Thursday that they will not receive retirement checks for an indefinite period because the city is broke.

At a special meeting of the Highland Park police and fire pension board, the mayor conceded that the city is required by law to make the payments, but said: "I just don't have the money."

During a heated exchange with Joseph Kolbe, a retired fire fighter and president of the Highland Park Retired Police and Firemen Association, Blackwell said he viewed the matter as a "personal obligation."

"We will have to go to court," Kolbe said.

"You do that," said the mayor.

The mayor said that last December the city took $165,000 out of the general fund to make pension payments. "The city no longer has any reserve funds," he said.

BLACKWELL SAID the approximately 200 retirees, drawing a total of $145,000 a month, outnumber the number of police officers and fire fighters on active duty. Highland Park has 125 police officers and fire fighters.

He assured active employes that payments would not be made to retirees from the $2 million of pension fund assets. State law forbids use of those assets for such payments.

In a letter to be sent to retirees, the city said payment will be suspended with checks due Feb. 1. Blackwell said he hoped the suspension would last for no more than two months, and that a loan could be gotten from the state to make up the missed payments.

He said that in order to maintain the system in the long term, it would be necessary to renegotiate pension provisions with police and fire unions.

Kolbe said the city had failed to notify retirees that their pensions were threatened, and that the suspension comes as a surprise.

Blackwell took exception to that statement. "This is a day that has been coming that everyone anticipated," he said.

THE DECISION to suspend pension payments was made by the pension board Jan. 19. The eight-member board is comprised of police officers, fire fighters, elected officials and a private citizen.

Retirees were not formally notified after the Jan. 19 meeting. The special meeting of the pension board Thursday resulted from controversy surrounding that decision.

The mayor said pensions are also threatened in other municipalities because of dwindling populations and an ailing economy. "We just happened to be the first to go under," he said.

Under the pension plan, retirees benefit from pay increases given to active workers. Blackwell, in citing an extreme example, said that there is a 92-year-old retired fire fighter now receiving an $11,000 annual pension even though he was only receiving $1,200 a year when he retired in 1943.

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ATTACHMENT #3

Dipping Into Pension Funds

By Luther Keith
News Staff Writer

LANSING — State budget officials, with the blessing of Gov. William G. Milliken, have their fingers in the pension cookie jar again.

And, once again, Michigan's budget crunch is the excuse.


Keith

This latest raid, which figures to save the state $101 million, drew only passing notice Monday when Milliken announced his plan to handle the state's growing deficit for the current fiscal year.

He asked the Legislature to approve $225 million worth of new cuts in higher education and local revenue-sharing and called on state department directors to trim their budgets by $51 million. The governor's press release also mentioned something called euphemistically "revised retirement funding" to save that $101 million.

THE WORD "revised," should have been "reduced." No one claims the reduced funding threatens future benefits — they're guaranteed by the Michigan Constitution — but is it sound fiscal policy?

Indeed, state budget experts concede it's possible, though they claim not probable, that this short-term savings could end up costing future generations of Michigan taxpayers more money.

The two funds affected by the changes are the state's largest, the Public School Employes Retirement System and the State Employes Retirement System.

Here's what would happen. State pension funds are financed

LANSING REPORT

through a combination of investment earnings and grants from the general fund. The lower the investment earning, the more money is required from the general fund to properly fund the system.

In the past, the state has calculated investment earnings at 6 percent interest a year. But this year, in the face of a swelling budget deficit, state pension officials recommended raising the investment calculation to 8 percent.

With the higher forecast, the state can reduce its anticipated general fund appropriation for pensions by $101 million. Of course, if the prediction proves too optimistic, your grandchildren will pay for the miscalculation.

Trustees of the teachers system already have voted 5-2 to go along with the change. The state employes fund board is still considering it.

All this troubles State Rep. Francis Spaniola, D-Corunna, chairman of the House Senior Citizens and Retirement Committee.

"This is definitely a budget-balancing device," said Spaniola, who argues in favor of a more modest 7 percent projection. "In the long run this will cost taxpayers more money if the pension system is weakened because of erroneous assumptions. I understand the state's in a bind and has to find a way to reduce costs, but I have a problem doing it with a system that has not been properly funded to begin with."

The multibillion dollar pension system always has been ripe for picking.

In the 1970s, the state was sued for using $460 million that should have gone toward future pension obligations to pay benefits that were due at that time — a practice that violated the state Constitution.

The Legislature, bailing out budget officials, approved a law legalizing the action before the courts acted.

IN 1980, the state wanted to use the pension funds to make a $150 million loan to Chrysler Corp. That idea was nixed when state employes objected.

Lawmakers approved single-year changes in 1980 and 1981 that allowed the state to reduce its pension payment by $24 million. Despite the fact that the law has not been changed for this year, the state continues to fund at the lower level.

DET NEWS
JAN. 29, 1982

ATTACHMENT #4

Dennis Corrected Copy

HOUSE OF REPRESENTATIVES
LANSING, MICHIGAN

67TH DISTRICT
FRANCIS R. "BUS" SPANIOLA
STATE CAPITOL
592 ROOSEVELT BUILDING
LANSING, MI 48909
(517) 373-0841

COMMITTEES:
SENIOR CITIZENS & RETIREMENT, CHAIRMAN
EDUCATION
SOCIAL SERVICES
TOWNS & COUNTIES
PUBLIC SAFETY

November 9, 1979

Governor William G. Milliken
State Capitol
Lansing, Michigan 48909

Dear Governor Milliken:

In recent weeks, the media have been filled with the latest development in the financial troubles of Chrysler Corporation. While most of the attention was focused on the federal level, the enclosed articles from the Detroit Free Press (attachment 1) and the Detroit News (attachment 2) brought the focus much closer to home. Both articles outlined the mortgage loan proposal which Dr. Miller and your staff were putting together while you were away.

The articles raised my concern about the possibility of obtaining a first and paramount lien against the Highland Park property. As you already know, they prompted me to write to Lee Iaccoca and to William Amerman to establish whether a first mortgage was possible and what procedures would be followed.

In your November 1 news conference, you made the formal announcement of the $150 million proposal (attachment 3) which included a first mortgage at prevailing rates on the international headquarters in Highland Park. You outlined the need for a first independent appraisal and a confirming second appraisal. You went on to say that Chrysler would be subject to a number of steps which the State Treasurer requires for prudent investment of state funds.

I was pleased to see your statement requiring Chrysler to follow any steps which the State Treasurer requires for the prudent investment of public funds. While I recognize the overwhelming need Chrysler has for financial assistance, I consider the fiduciary standards the State Treasurer has the responsibility to uphold in the investment of pension assets to be of paramount importance.

During your August 10 press conference, when you announced the purchase of 800 Chrysler automobiles for state use, you were asked if it was embarrassing to have the state investment officers selling off stocks and securities from the Big Three. To your credit, you responded:

> I think it reflected the policy of the department in seeking the best investments and we are constantly changing our portfolios . . . to get the best return we can. That's the intent of the law under which that department functions. So, I would not characterize it, as far as I am concerned, as being embarrassing . . . .

Of course, the policy of Treasury is carried out within the legal framework of Public Act 314 of 1965, and Public Act 232 of 1969 which bears your signature. Public Act 314 authorizes the investment of public funds and sets forth the conditions and limitations of those investments. Public Act 232 of 1969 established the independent Investment Advisory Committee whose function it is to review the investments, goals and objectives of each of the retirement funds and to submit recommendations on the same. These Michigan laws, supported by pertinent sections of the Internal Revenue Code and numerous court cases, reinforce the necessity for the highest standards of prudence in carrying out our trust responsibilities for public funds.

On the day after your press conference announcing the Chrysler proposal, both the Detroit Free Press (attachment 4) and the Detroit News (attachment 5) carried follow-up articles. Dorothy Eubank is quoted in the Free Press as saying her members "already have strong misgivings" and may block the loan. You are quoted in the News as predicting some "misunderstandings and fear" among public employee groups, but that you would "insist that the mortgage be made despite any complaints."

Perhaps I have also misunderstood you: Under what authority can you insist a mortgage loan to Chrysler be made? The provisions of Public Act 232 require a unanimous vote of the Investment Advisory Committee to direct the State Treasurer to make specific investments. This need for unanimity provides strong protection for the prudent investment of pension funds. Further, Section 942 of the Insurance Code sets forth the limitations and conditions for the investment of pension funds in real-estate loans. Just as you pointed out in your November 1 press conference, the mortgage loan will be subjected to a number of steps which the State Treasurer requires for prudent investments, some of which are spelled out in Section 942.

As for the required appraisals, I would expect them to establish and confirm the market value of the property as collateral for such a first mortgage loan. The only reasonable method of appraising the Chrysler property is to establish the value the pension funds could reasonably expect to receive should the Treasurer have to sell the property upon foreclosure. Indeed, any other method of valuing, such as value in use or going concern, may render the loan imprudent by overstating the value of the collateral and raising the element of risk to the fund beneficiaries.

The reported value of Chrysler headquarters property continues to shrink with further scrutiny. In the October 27 Free Press article, Chrysler officials were reported to have placed its value at $1 billion, while other sources placed its value at $200 million. In a meeting last week with representatives of Treasury, Chrysler officials stated their headquarters was on the Highland Park tax rolls for $44.5 million. A check with the Highland Park city assessor reveals the total assessed valuation to be only $26.2 million.

Given the $150 million loan you have proposed, I cannot help but strongly question the quality of the work which Dr. Miller and his staff have done for you in putting this package together. It seems as though Dr. Miller has given you advice based on political expediency rather than on prudent investment practices. You could well set a precedent by initiating the first gubernatorial interference with the standard investment procedures of the State Treasurer as well as ordering an imprudent loan.

I think you should also be very concerned how the Supreme Court may review your proposal to make a loan of questionable prudence with Michigan Public School Employees Retirement System (MPSERS) assets. As they finish reviewing the Kosa case, they might wonder if the MPSERS fund can stand the further financial strain which the potential loss of $120 million might cause. Indeed, if the system had not been underfunded by some $460 million over the years in question, it would be in much better financial shape to make such an investment.

Finally, let me offer some thoughts on investments which are sometimes referred to as "social investments." I have enclosed a copy of a January 14 Flint Journal article (attachment 6) by Robert Longstaff. In it, he takes the Speaker of the House and Senate Majority Leader to task for their Opening Day Remarks on the subject of the investment of pension funds. I wrote a letter to the editor (attachment 7) in response to the manner in which Longstaff grossly misrepresented the Democratic leadership as seeing "pension fund money as a source of financing for social good works." What I said to Ray Stevens then holds even more true now:

> . . . Our interest is in providing the best possible return on investment while enhancing the economic and social lives of the citizens of the state . . . . Neither Speaker Crim, Senator Faust, nor I would support an imprudent investment policy. On the contrary, we seek to meet the investment standard of prudence while acting in a manner to best serve all the citizens of Michigan.

I continue to support the prudent use of pension assets in enhancing the economic life of this state and all of its citizens. An investment in Chrysler which meets the same high standards of prudence used to judge other mortgage loan applications would receive my unfailing support. Conversely, I remain steadfastly opposed to the imprudent investment of public assets or any other public funds under our trust.

pension

Governor William G. Milliken
Page 4
November 9, 1979

Governor, it appears the mortgage which you propose may not be prudent. You stand to reap the whirlwind of angry pensioners by "insisting" on this loan. I think you would be better served to seek other investment arrangements which offer a viable investment opportunity for pension fund assets in Chrysler. As Chairman of the Senior Citizens and Retirement Committee, I stand ready to work with you in putting together alternative proposals which respond to Chrysler's needs.

May I hear from you on this matter at your earliest convenience.

Respectfully,

Bus

Francis R. Spaniola
State Representative
87th District

cc: Attorney General Frank J. Kelley
Dr. Gerald Miller, Director of Management and Budget
William McLaughlin, Director of Commerce
Loren Monroe, State Treasurer
Appointed Members of the Investment Advisory Committee
Speaker Bobby D. Crim
Senator William Faust
Senator Jerome Hart
Senator David Plawecki
Representative Dominic Jacobetti
Members of the House Senior Citizens and Retirement Committee
William Amerman, Director of Investments
Dorothy Eubank, Retirement Coordinating Council
David Winters, Michigan State Employees Association

Attachments:

1. Detroit Free Press article dated October 27, 1979
2. Detroit News article dated October 26, 1979
3. November 1 News Release
4. Detroit Free Press article dated November 2, 1979
5. Detroit News article dated November 2, 1979
6. Flint Journal article dated January 14, 1979
7. Letter to Ray Stevens dated January 26, 1979

ATTACHMENT #5

HOUSE OF REPRESENTATIVES
LANSING, MICHIGAN

87TH DISTRICT
FRANCIS R. "BUS" SPANIOLA
STATE CAPITOL
592 ROOSEVELT BUILDING
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(517) 373-0841

COMMITTEES:
SENIOR CITIZENS & RETIREMENT, CHAIRMAN
EDUCATION
SOCIAL SERVICES
TOWNS & COUNTIES
PUBLIC SAFETY

August 10, 1981

Joe H. Stroud, Editor
Detroit Free Press
321 W. Lafayette Blvd.
Detroit MI 48231

Dear Mr. Stroud:

I read your editorial of August 9 on the Detroit Rescue Plan with mixed emotions. Your strong support for the Mayor and your respect for all who have already sacrificed to help the Mayor pull off two goals of his "hat trick" are most laudable. But your limited understanding of the fundamental principles embodied in pension plans and the prudent investment of their assets is most dismaying.

You missed the point when you chastised the "...balky trustees...for refusing to accept any responsibility for the city's fate, or to respond to any appeal to civic loyalty and pride." The most fundamental duty owed by the trustees is the duty of loyalty to the fund beneficiaries, the duty to avoid self-dealing and self-interested management, and to manage the trust solely in best interests of the fund beneficiaries. This basic principle of prudence has over 150 years of common law legal tradition since the 1830 Harvard College v. Amory case. Civic pride and civic loyalty may be highly valued by all the trustees, but they cannot hold them before their duty to the fund beneficiaries.

You were too quick to dismiss the problem which the terms on the bonds being offered the trustees poses for them. An August 6 Free Press article by Tom Hundley pointed out how the same terms provide much more incentive to the banks than to the pension funds because the pension funds are already tax-exempt. The Secrest Committee Report described the same problem, yet your editorial dismissed the lost earnings potential as "insignificant."

First, current market conditions offer the trustees the opportunity to invest the same \$62.5M in 30 year high grade utility bonds at yields of 17 percent callable after five years. The city offers a yield of less than 14 percent with the bonds callable after two years. Given the generally accepted view that long-term interest rates are going to come down in the near future, if the city were to exercise its call provisions, the trustees would be in the unenviable position of having to reinvest the entire \$62.5M two years hence in a market where long-term rates may have dropped to 10 percent. Thus, they will have at

Joe H. Stroud, Editor
Detroit Free Press
August 10, 1981
Page two

least foregone the 3% difference for two years and possibly 7% for three years, a certain loss of $2.5M during the first two years and a potential loss of $13M over the next three years.

Second, by refusing to offer the trustees a yield which would make the bonds a prudent purchase for the pension funds, the city cheats both future taxpayers and fund beneficiaries. Since the obligations to the fund have not diminished, every dollar of foregone interest earnings will have to be replaced with a future tax dollar. A prudent level of yield from the bonds would strengthen the fund in the short run and likely lower the future burden on taxpayers in the long term.

The bond purchase will add risk to the portfolio and the P & F retirees are the most vulnerable to that risk because the P & F plan assets are sufficient to cover only slightly more than one-half of the total IOUs held by the retirees ALONE! When NYC public pension funds purchased MAC bonds during 1975-78, a NYC firefighters fund in a similar actuarial condition was excluded from purchasing the bonds because it was not actuarially sound enough to buy them. Jonathan Schwartz, actuary for the City of New York then and now, said it would be "unconscionable" for the Detroit P & F fund to buy Detroit bonds under the same circumstances.

If the difference in interest costs to the city for the two years is as "insignificant" as your editorial asserts, then the city would be well advised to pay the small additional cost. Consider the return on such an investment: First, the trustees can uphold their fiduciary duties to the standards required of them without worry of a lawsuit. Second, the taxpayers may avoid higher tax dollar requirements to meet future pension obligations. Finally, the city gets the money it needs to balance it's budget.

In conclusion, if the city would only make the pension funds a prudent offer they could not refuse, I have no doubt the trustees would be most willing to show their civic pride and loyalty. Then we could all stand and cheer the Mayor's remarkable "hat trick."

Sincerely,

Francis R. Spaniola

Francis R. Spaniola
State Representative
87th District

FRS:ld

ATTACHMENT #6.

2 / Pensions & Investment Age, February 1, 1982

IRS permits Detroit debt for city funds

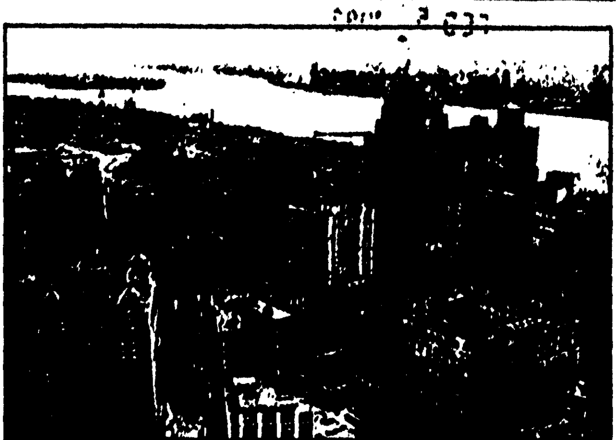
By Pavan Sahgal

DETROIT—The Internal Revenue Service appears to have set a precedent in allowing certain employe retirement systems to purchase employer debt under special circumstances. Ordinarily, the U.S. tax code does not permit such investments.

The IRS ruling came in a largely unpublicized private letter written in connection with Detroit's recent financial crisis. Consequently, two city funds bought 50% of a $113 million special municipal debt offering while local banks purchased the other half.

The Detroit General Retirement System and the Detroit Policemen and Firemen Retirement System each bought $28.5 million of the new debentures, with staggered maturities in April 1983, April 1985, and April 1986 at 13% and a discount in November 1981.

Though IRS private-letter rulings do not bear the formal stamp of approval of a published revenue ruling, the Detroit case is considered significant by industry analysts. First, it comes at a time when pension funds are being eyed by state and local officials as ready sources of financing. Secondly, they view as unlikely that the IRS would abruptly eat its words in a new case.



Detroit: An IRS ruling allows the city public funds here to purchase half of a $113 million debt offering designed to ease Detroit's financial crunch

"There are cities out there that are strapped financially," comments Leon J. Karvelis Jr., vp fixed income research at Merrill Lynch, New York. "They'd rather go to their own funds than pay usurious market rates."

The IRS answered two of three key issues posed by the Detroit retirement plans: first, that the city's "economic circumstances as principal contributor and ultimate obligator for retirement benefits" be taken into consideration in determining whether the bond purchases would satisfy the "exclusive benefit" rule of Section 401(a); and second, that the bond purchase "be treated as a bona fide collection effort of delinquent contributions," or in other words, that the investment be seen as a collection of a bad debt. (City plan representatives later wrote the IRS to strike off this issue from their request for rulings. According to Fred Murphy, executive secretary for the Detroit Retirement Systems, this was done after lawyers concluded that an an-

Continued on page 44

IRS permits city debt . . .

Continued from page 2

swer to the third question would make the second one unnecessary.)

Third, the city retirement plans asked whether the bank purchase of part of the bonds would be treated as "an acquisition by persons independent of the issuer."

The IRS wrote in answer to the first question: "In determining whether a course of action is for the exclusive benefit of the employes within the meaning of section 401(a) of the Code, the trustees of the two plans must discharge their duties with the care, skill, prudence, and diligence under all 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 like character and with like aims. In this case, among the circumstances prevailing at the time of the commitment of the General and Uniform Services Funds are the obligations of the City to fund the plans, the failure of the City to meet that obligation, and the adverse economic circumstances of the City which resulted in the limited alternatives available to the Funds in pursuing collection of the delinquent contributions.

"Accordingly, with respect to the first ruling request, for purposes of the exclusive benefit rule, these economic conditions can be taken into account together with all the other facts and circumstances in establishing the terms, including the interest rate, for the portion of the delinquent contributions that will be satisfied by the bonds."

The IRS comment knocked over its own fiat of the 70s concerning New York City's fiscal crisis. At the time, the IRS refused New York permission to borrow from its pension funds. The city later obtained statutory congressional permission to do so.

"The ruling also goes in the other direction by indicating that the greater the degree of economic weakness, the more the terms and conditions should be in favor of the city," said Mr. Karvelis.

The ruling on the third issue apparently was sought by the Detroit funds to establish that local banks were acting independently and not as investors in cahoots with the funds. ■

ATTACHMENT #7

Law

P LAW SPECIALIST CRITICIZES DETROIT BONDS RULING

BY JOHN CONNOR

WASHINGTON -DJ- ROY SCHOTLAND, GEORGETOWN UNIVERSITY LAW PROFESSOR AND PENSION LAW SPECIALIST, SAID THE INTERNAL REVENUE SERVICE RULING THAT ALLOWED THE CITY OF DETROIT TO SELL SOME $56.5 MILLION OF SO-CALLED DEFICIT BONDS TO TWO CITY PENSION SYSTEMS LAST MONTH IS @@CLEARLY WRONG.''

CALLING THE IRS'S DETROIT RULING @@VERY TROUBLESOME,'' SCHOTLAND LIKENED IT TO A DEFECTIVE CAR AND SAID, @@THE SOONER IT'S RECALLED, THE BETTER.''

HE SAID FEDERAL AUTHORITIES @@AT THE VERY LEAST SHOULD HAVE TOLD DETROIT TO GO GET THE SAME THING NEW YORK CITY GOT''-- SPECIFIC AUTHORIZATION FROM CONGRESS TO SELL CITY SECURITIES TO CITY PENSION FUNDS.

@@I HAVE NO OBJECTION TO USING A PENSION FUND AS A FINANCIAL BRIDGE, BUT THIS (THE DETROIT RULING AND BOND SALE) MAKES A PENSION LOOK LIKE A BANK,'' THE LAW PROFESSOR SAID IN A TELEPHONE INTERVIEW WITH THE DOW JONES CAPITAL MARKETS REPORT.

HE SAID THE DETROIT RULING WILL BE SEIZED UPON BY OTHER FINANCIALLY STRAPPED CITIES AS A WAY OF OBTAINING FUNDS AND PERHAPS ALSO BY CORPORATIONS.

NOTING THAT DETROIT SOLD HALF OF A TOTAL OF $113 MILLION OF DEFICIT BONDS TO LOCAL BANKS AT THE SAME INTEREST RATE THE PENSIONS RECEIVED, SCHOTLAND SAID @@THERE'S NO WAY A TAX EXEMPT ENTITY, THE PENSIONS, SHOULD TAKE THE SAME RATE ON TAX EXEMPT SECURITIES AS TAXABLE ENTITIES, THE BANKS.

@@EITHER IT'S A GIFT TO THE BANKS OR A RIP-OFF OF THE FUNDS,'' THE GEORGETOWN LAW PROFESSOR SAID, OPINING THAT @@IT'S A RIP-OFF OF THE FUNDS.''

@@IF I WERE A TRUSTEE OF THE PENSION FUNDS, I WOULDN'T BE SLEEPING AT NIGHT,'' SCHOTLAND ADDED.

DETROIT ASKED THE IRS TO RULE ON THE SALE OF BONDS TO ITS PENSION FUNDS LAST SUMMER AFTER FEDERAL OFFICIALS RAISED QUESTIONS AS TO WHETHER THE TRANSACTION WOULD BE PERMISSIBLE UNDER FEDERAL TAX RULES GOVERNING PENSION PLAN INVESTMENTS.

THE IRS, IN A LETTER RULING HANDED DOWN OCT. 30, RULED FAVORABLY FROM DETROIT'S POINT OF VIEW ON TWO OF THREE QUESTIONS AT ISSUE, AND DETROIT SOLD THE BONDS TO ITS PENSION SYSTEMS SHORTLY THEREAFTER. THE IRS DID NOT RULE ON WHETHER THE SALE OF CITY BONDS TO ITS PENSIONS FELL WITHIN THE SECTION OF THE TAX CODE DEALING WITH @@PROHIBITED TRANSACTIONS,'' SAYING THAT QUESTION @@WILL BE ADDRESSED AT A LATER DATE.''

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Senator CHAFEE. Thank you very much, both of you, for that very fine statement. I think the point you made on page 7 about the investment in tax-exempt securities, which obviously have a lower yield, to an organization such as the State pension funds, which are tax-exempt anyway, is very interesting.

Mr. SPANIOLA. Yes; we just had a case, sir, in the city of Detroit which caused us great alarm. Also, Dr. Roy Schotland had some comments to make about that as well.

We recognized that the IRS even did some things that were questionable as far as we were concerned and as far as Dr. Schotland was concerned. An interest-free loan, so to speak, went to the city of Detroit because of the lower yield. We did not believe that they followed their fiduciary responsibilities at all in that case.

Senator CHAFEE. What do you gentlemen say to the testimony that was presented previously by the panel of Senator Clark, Mr. Natale, and Councilwoman Kreamer in which they indicated that if there are problems out there, they are being met by the State legislatures and the Governors by the passage of this legislation. What do you say to that?

Mr. HACKING. Senator, this is extremely modest legislation we are talking about here. I had a little problem with the comments of the preceding panel when they alleged that this legislation was going to impose additional burdens on them and that, to the extent that there were problems out there in the past, these problems are being rectified by the States and localities themselves.

The fact is we do not have enough meaningful information at the Federal level to know the full extent of the problems that do exist or whether progress is being made in overcoming them.

Therefore, to the extent that you can put into place minimum standards, the only ones that are going to have to raise their effort or provide more disclosure are those that are not meeting these bare minimums now. As I say, these are very modest minimums we are talking about.

Senator CHAFEE. Mr. Spaniola.

Mr. SPANIOLA. Well, sir, I do not believe that the States' legislatures collectively are doing the job that is necessary. I have some real concerns about using the argument that the Feds ought to put their house in order before they tell us what to do. That argument was used on me by my local municipalities. They told the State to keep their nose out of their business. It just does not follow, so far as I am concerned.

I think there is a problem there. Whether the Feds are doing their job adequately at the moment is beside the point as far as I am concerned. The State that I am from is not doing its job adequately. The municipalities are not doing the job adequately.

I do not want to waste my time arguing about who is at fault. I want to see something done. So I am telling you here, and everyone else concerned, that I think that is a pretty weak argument and that the time ought to come that we recognize that.

Senator CHAFEE. What would you say if we passed legislation that required the States to adopt a model bill such as we have, but then once that was done, no further reporting was due to the Federal Government. The local taxpayers and beneficiaries could sue.

Now, this proposal overcomes, it seems to me, the concerns of the massive regulations and continuous oversight. What might be even worse is for the Federal Government not even to do any oversight; they might claim to but not.

What would you say to the Federal Government shedding this responsibility once the State passed the enabling legislation? What do you say to that, Mr. Hacking?

Mr. HACKING. Well, I do not know that that goes far enough, Senator. If you put into place legislation that establishes minimum standards and then the States pass certain legislation requiring retirement systems within their jurisdictions to conform, how are we to be certain that those retirement systems do in fact end up conforming? There has to be some kind of monitoring and reporting. Without that, we would have no assurance that the standards are really being met by all of those retirement systems that are within the State's jurisdiction.

Senator CHAFEE. Well, the beneficiaries of each plan would then have the basis for a suit.

Mr. HACKING. Well, that puts a burden on the beneficiaries.

Senator CHAFEE. Well, I know it places a burden, but it is a pretty powerful threat. Some of these organizations are fairly well organized, such as yours.

What I am trying to do is to balance these concerns, there are those who say, here is the Federal Government preaching the new federalism, suddenly going into this business, and never getting out.

They say, pass legislation in Michigan or wherever, but we are going to watch over your shoulder. That is what might give us a rub in getting this legislation passed.

Mr. HACKING. Well, with respect to the scheme you just described, we would say it is certainly better than what we have now—nothing. To that extent, we would go along with it, but it is weaker than what we are talking about here in terms of S. 2105 and S. 2106.

This legislation has been well watered down over the years. We would hate to see the standards and the enforcement mechanisms of this legislation diluted even further.

Senator CHAFEE. There would be no dilution in the standards. I am solely talking about the reporting, and presumably the enforcement, if you want to use that rough word, which the Federal Government would have.

Mr. HACKING. Well, we think those reporting elements are just as essential as the standards themselves.

Senator CHAFEE. Mr. Spaniola.

Mr. SPANIOLA. Yes; Mr. Chairman, 6 months ago I would have agreed with that statement that we could disengage after a fashion. I do not believe that anymore, based upon some experience that I have had in Michigan. We have some rather strict constitutional provisions dealing with public pensions. That does not seem to phase anyone in my State that make these decisions.

I would be very uncomfortable if you were to suddenly disengage and let us go our own way. I am not going to say that I am qualified to say that I know what is going on in the other 49 States. But from my perspective, I think there has to be some minimal scrutiny of what the States are doing.

Senator CHAFEE. I see. Fine.

Senator Matsunaga.

Senator MATSUNAGA. Thank you, Mr. Chairman.

I thank you both for appearing. I especially thank you, Mr. Spaniola, for pronouncing my name right. I suppose it is because of the good Italian name. [Laughter.]

But you heard the testimony of the representative this morning who appeared on behalf of the National Conference of State Legislatures, the Committee on Pensions and for the National Governors Association.

Now, is the National Retired Teachers Association willing to work with the sponsors enough to neutralize the lobbying efforts of these organizations?

Mr. HACKING. Yes, we are, Senator.

Senator MATSUNAGA. How would you respond, both of you, to the points raised by the National Conference of Legislatures and the Governors Association?

Mr. HACKING. Well, to the extent that the objection was that, since the States and localities are, in effect, cleaning up their act with respect to State and local public retirement systems, this legislation is unnecessarily or positively harmful, we disagree. This legislation would set some very modest standards relative to reporting, disclosure, and fiduciary conduct. If State and local retirement systems are all doing so well, this legislation is not going to impose any substantial additional burdens on them.

The only systems that are going to find this legislation a little burdensome are those that are not meeting these very modest standards. It is precisely those retirement systems that need to be brought up to the minimum.

I would also add, since you mentioned the Retired Teachers, that ever since the mid-1970's experience of the five retirement systems in the city of New York, beneficiaries of those systems have continued to express strong interest in the enactment of PERISA-type legislation to set fiduciary standards to preclude the kind of situation we witnessed at that time.

That is a basic reason for our continuing to support this kind of legislation. We think it is needed, and we will continue to do all that we can to see that it is enacted.

Senator MATSUNAGA. Representative Spaniola.

Mr. SPANIOLA. Thank you, Senator. I pretty much concur with what my colleague here has just said. I can tell you that we had an experience in Michigan that is worth reporting, I think. One experience, well, we have had dozens of them, but I will report one of them because time is of the essence.

Last December we passed a bill that I authored that established a pension oversight body. That pension oversight body is not functioning at the moment because it has not been funded. Let me tell you why, sir. At the same time that bill passed, my colleagues were trying to jam through my committee a bill that would have sweetened our own pensions at a level that was so unconscienable that I could not stomach it, if I can put it that way, and that I could not face the other people that were coming before me asking for benefit increases and having to refuse them.

My colleagues are worried now that the legislative retirement system is going to be scrutinized by that body, and they do not want to institute the operation of it. I think that is a real good argument to use when we say we have to be a little bit worried about what goes on at the local or at the State and local level, and why we need some kind of Federal overview.

Senator MATSUNAGA. Thank you very much. Of course, you have some problems which we have at the national level, too, I can see.

Mr. SPANIOLA. We have severe problems in Michigan, sir. There is a deep depression there.

Senator MATSUNAGA. Well, I see that according to the chairman's schedule that we are running overtime.

Senator CHAFEE. Fine. Well, thank you, Senator Matsunaga.

Thank you, Mr. Spaniola and Mr. Hacking both, and those with you.

The final panel, Governor Peabody, Mr. Klausner, and Mr. Schotland. Now, these very distinguished lawyers will discuss the legal and constitutional implications of the PERISA legislation, all in 25 minutes.

So, Governor, we welcome you here and look forward to your testimony.

STATEMENT OF HON. ENDICOTT PEABODY, FORMER GOVERNOR, STATE OF MASSACHUSETTS

Governor PEABODY. Thank you, Senator. Mr. Chairman, my name is Endicott Peabody, and I am an attorney here in Washington in the firm of Peabody, Lambert & Meyers, where I have practiced for the past 14 years. I am appearing today in behalf of OPPOSE, a Colorado corporation whose members include public employee associations from Colorado, Nevada, and Ohio.

To date the efforts of OPPOSE have been focused primarily on maintaining the independence and integrity of the public employee retirement industry for mandatory social security coverage for State employees.

OPPOSE now wishes to register its strong opposition to S. 2105 and S. 2106, each entitled the Public Employee Retirement Income Security Act of 1982, of PERISA. Mr. Chairman, we have submitted a statement, which I will not read but which I would ask you to have incorporated in the record.

Senator CHAFEE. We certainly will.

Governor PEABODY. Mr. Chairman, the associations which I represent compliment you and this committee as well as the House committee for your concerns with the problems of pensions in the States and in the local areas. We disagree, however, with your proposed solution. PERISA would impose Federal regulatory requirements upon all State pension plans for the first time.

We believe that these provisions are unwise as a matter of policy. But we also believe that these bills, if enacted, would be an unconstitutional intrusion on the right of the individual States to determine and regulate their relationships with their own employees.

This issue is discussed at considerable length in the written statement which we supplied for the committee.

But the basic argument is simple: Both the 10th amendment and the Federal scheme embodied in the Constitution which allocates power between the States and the National Government prevents Congress from transgressing upon State functions which are essential to separate and independent existence.

In *National League of Cities* v. *Usery* the Supreme Court held that State and local governments could not be compelled to accept Federal minimum-wage and hour standards because this would interfere with the fundamental right of the States to shape and determine employment relationships with their employees.

S. 2105 and S. 2106 would interfere with the rights of the States to regulate their own pension systems, including disclosure standards and protections for their employees afforded by fiduciary standards. PERISA would impose burdensome reporting requirements on the States, thus supplanting the State's own judgment as to the level of protection that should be afforded to its employees and thus the usefulness of certain information.

In addition, PERISA would establish Federal standards of fiduciary responsibility that might vary from the State's own rules and would curtail the discretion that a fiduciary exercises in investing in pension plans funds.

Moreover, the State would be required to establish and maintain a bureaucratic structure to comply with the Federal rules and the State and, in some instances, the plan itself would bear the cost of compliance.

PERISA, Mr. Chairman, is an attempt by Congress to exercise its commerce power in an effort that is foreclosed to it by constitutional principles of federalism. It is plainly a "congressionally imposed displacement of State decisions that may substantially restructure traditional ways in which the local governments have arranged their affairs," quoting the *National League of Cities,* 426 U.S. at 849.

It is a direct attempt by Congress to regulate fundamental employement decisions made by the State. PERISA falls squarely within the rule of NLC and is unquestionably unconstitutional.

I might point out, Mr. Chairman, as you have yourself, that the Federal pension plans are in deep trouble, particularly the Social Security fund, but also others. The States have no more right to come in and attempt to solve that, than the United States has to invade and tamper with the States' prerogative.

In this area we are both sovereign. In short, you should take care of your pension problems and the States should take care of ours. This does not underestimate the fact that they are both serious and they both need attending. But not by each other.

Again, as you have pointed out, Mr. Chairman, this legislation is running just counter to the direction of the new federalism. It is sort of a denial of the new federalism direction, it seems to me, for the Congress of the United States to come up with a bill which counters it in 1982, when you are telling the States that they are equipped to handle their own matters, and indeed they are.

You have mentioned also earlier a model statute. A model statute would be fine, but it does not need Federal legislation to do it.

The Advisory Commission on Intergovernmental Relations has prepared one, as I understand it. Great publicity and attention should be given this.

I do not underestimate the importance of the problem. We merely take great exception to the ways in which this problem is being met.

One final point, Mr. Chairman. And that is that in my home State we have the provision for an advisory opinion by the Supreme Court as to certain legislation involving constitutional problems. It is too bad that the Federal Constitution does not permit such an advisory opinion.

But I do believe that before this committee or the House committee goes any further with this legislation, that you should have the advice of distinguished constitutional lawyers who can express themselves on the constitutionality of these proposals.

[The statement of Governor Peabody follows:]

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STATEMENT
OF OPPOSE
ON S. 2105 and 2106 ("PERISA")
before the
Senate Subcommittee on Savings, Pensions,
and Investment Policy
March 29, 1982

I. INTRODUCTION

The Organization for the Preservation of the Public Employment Retirement Industry and Opposition to Social Security Expansion to Such Industry ("OPPOSE") is a Colorado corporation whose members include public employee associations from Colorado, Nevada, and Ohio. To date, the efforts of OPPOSE have been focused primarily on maintaining the independence and integrity of the public employee retirement industry from mandatory Social Security coverage for state employees. OPPOSE now wishes to register its strong opposition to S. 2105 and S. 2106, each entitled Public Employee Retirement Income Security Act of 1981 ("PERISA").

PERISA would impose federal regulatory requirements upon state pension plans for the first time. Most of S. 2106 is identical to portions of S. 2105. Both bills impose the same reporting and disclosure requirements upon the states. The bills establish very similar fiduciary responsibilities, although S. 2106 goes into somewhat more depth in defining fiduciary functions and liability relating thereto, and in delineating transactions prohibited to a plan. S. 2106 places a 5% limitation on the acquisition of employer securities by a plan, while S. 2105 places a 10% limitation on such acquisitions.

In addition, S. 2105 contains several provisions not found in S. 2106. S. 2105 modifies the Social Security Act to require that the Secretary of Health and Human Services be provided with certain information contained in the annual reports submitted by the pension plans. The Secretary must then provide that information to individuals upon request. The Internal Revenue Code is also amended by S. 2105 to disqualify as tax exempt a trust that does not satisfy the requirements of PERISA. Finally, S. 2105 establishes the "Employee Benefit Administration" as an independent agency within the executive branch of the government to administer PERISA. S. 2106 delegates that responsibility to the Secretary of Labor.

Other witnesses before this and other congressional committees have already testified eloquently to some of the deficiencies of PERISA. The Honorable James Clark noted the burden of the reporting and disclosure requirements set forth in the proposed legislation, and stated that it is premature for Congress to mandate a uniform reporting standard for the states and their political subdivisions when there is no consensus on standards of reporting and disclosure even among the community of finance professionals.

Bernard Rosen, of the Office of Management and Budget of the City of New York, described the burden on a city such as New York of the percentage limitations on acquisitions of employer securities that PERISA would create for public pension plans. Michael N. Thome, as well as others, described the steps that state and local governments are taking to correct admitted inadequacies in existing state and local pension plans.

OPPOSE believes that these and other arguments brought forward by previous witnesses demonstrate why PERISA is unwise as a matter of public policy. Our comments will therefore express our view that enactment of PERISA, in the form of either bill, would constitute a grievous and unconstitutional intrusion into state affairs by the federal government.

II. THE FUNDAMENTAL CONSTITUTIONAL DOCTRINE OF FEDERALISM PROTECTS THE STATES FROM INTRUSIONS BY THE FEDERAL GOVERNMENT.

A. In the Recent Case of National League of Cities v. Usery, the Supreme Court Reaffirmed Its Constitutional Mandate to Protect the Functions Essential to the Separate and Independent Existence of the States.

Among the enumerated powers granted to Congress by the Constitution is the power "To regulate Commerce ... among the several States." U.S. Const. art. I, § 8. Thus the power of Congress to enact private pension legislation such as ERISA is beyond constitutional challenge.

However, as the Supreme Court has quite recently observed:

> It is one thing to recognize the authority of Congress to enact laws regulating individual businesses necessarily subject to the dual sovereignty of the government of the Nation and of the State in which they reside. It is quite another to uphold a similar exercise of congressional authority directed, not to private citizens, but to the States as States. [The Supreme Court] ha[s] repeatedly recognized that there are attributes of sovereignty attaching to every state government which may not be impaired by Congress, not because Congress may lack an affirmative grant of legislative authority to reach the matter, but because the Constitution prohibits it from exercising the authority in that manner.

National League of Cities v. Usery, 426 U.S. 833, 845 (1976) (hereinafter "NLC"). Both the tenth amendment 1/ and the federal scheme embodied in the Constitution, which allocates power between the states and the national government, prevent Congress from transgressing upon state "functions essential to separate and independent existence." Id.

In NLC the Supreme Court invalidated a statute that intruded upon state sovereignty in a manner similar to that in which PERISA would abrogate state authority. The question

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1/ The tenth amendment provides that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

raised was whether Congress could lawfully impose minimum wage and maximum hour requirements upon the states as employers. 2/ The Court reasoned that "[o]ne undoubted attribute of state sovereignty is the States' power to determine the wages which shall be paid to those whom they employ in order to carry out their government functions, what hours those persons will work, and what compensation will be provided where those employees may be called upon to work overtime." Id.

B. PERISA Would Impair Functions Essential to the Separate and Independent Existence of the States.

1. The Impact of PERISA Upon the States Would Be Severe.

The Court in NLC attempted to mark out the bounds beyond which the federal government may not intrude by identifying "functions essential to the separate and independent existence of the state," and the "substantial and traditional attributes of state sovereignty." The outer boundaries of the protected area may be somewhat hard to define; running a police force is protected, while running a railroad is not. 426 U.S. at 851. Whatever the protected attributes of state sovereignty may be, however, the only way they can be implemented by a state is through its employees. Since in NLC the Fair Labor Standards Act affected state employer-employee relationships,

2/ Specifically, the case considered the constitutionality of the 1974 amendments to the Fair Labor Standards Act, 29 U.S.C. §§ 203(d), (s)(5), and (x), which removed the exemption from minimum wage and maximum hour requirements previously afforded the states and their political subdivisions.

it went to the very heart of all sovereign functions of the state.

A state's pension plan is a significant part of the total compensation plan that a state offers its employees. NLC expressly forbade federal interference with the manner in which the state governments formulate their employees' compensation plans. One of the primary evils of the proposed act is the fact that both bills grant open-ended regulatory authority to federal agencies. S. 2106 provides in Section 303 that the Secretary of Labor "may prescribe such regulations as the Secretary finds necessary or appropriate to carry out the provisions of this Act." S. 2105 creates an entirely new independent agency, the "Employee Benefit Administration," to regulate state employer-employee relations.

Even a cursory reading of the bills reveals that the effect of PERISA would be to interfere severely with the manner in which a state has chosen to administer its employees' pension plan. PERISA would impose burdensome reporting requirements upon the states, thus supplanting a state's own judgments as to the level of protection that should be afforded to its employees and as to the usefulness of certain information. In addition, PERISA would establish federal standards of fiduciary responsibility that might vary from the state's own rules, and would curtail the discretion that a fiduciary may exercise in investing a pension plan's funds. Moreover, the state would be required to establish and maintain a bureaucratic structure to comply with the federal rules and the state (and, in some instances, the plan itself) would bear the costs of compliance.

S. 2106 includes 22 pages of legislation setting forth what must be included in the plan's annual report, which must be provided to all participants and beneficiaries of the plan, and to others upon request. Each employee who was separated from service within the previous year must be listed, as must that employee's taxpayer identification number and detailed information about the benefits to which he is entitled. (This information is also provided to each such person individually.) This listing may be administratively burdensome for some larger plans, and it is potentially a serious invasion of the privacy of such individuals to publish the status of their accounts and the fact that they are now separated from service covered by the plan. (They would be obvious targets for commercial solicitations, for example, which are prohibited by PERISA only to persons who request information in a computer-compatible form.)

PERISA also requires that the annual report list the names of each person who received compensation from the plan, their job descriptions, and the amounts of their compensation. This list may also be burdensome in length, an invasion of the privacy of employees of the plan, and of little use or interest to participants of the plan. The annual reports must state the reason for any change in attorneys, trustees, or other professional personnel by the plan. This may inhibit effective plan management; plan administrators may need to terminate a professional relationship, but be unwilling to publicly embarrass such a professional by detailing their dissatisfaction with that person.

PERISA would place a significant burden upon the states in areas beyond the disclosure requirements. PERISA would supplant state standards with federal requirements in the areas of fiduciary functions, plan establishment, establishment of a trust, prohibited transactions, liability for failure to meet fiduciary standards, prohibition against certain persons holding certain positions, and the bonding of employees. The bills also contain limitations with respect to acquisitions of employer securities or other employer obligations which would impair the plan's right to purchase state or local government bonds regardless of the merits of this investment. Furthermore, PERISA would create a federal cause of action, to be adjudicated in federal courts, for virtually any individual disgruntled with a state pension plan. These requirements could, arguably at least, inhibit the plan's ability to attract capable administrators, might require the state to enter into indemnification agreements, and might be inconsistent with already existing state rules.

Not to be overlooked are the costs that attend all of the requirements that would be imposed by PERISA and borne by the states. The costs of establishing a bureaucratic structure to comply with PERISA and the regulations promulgated thereunder could be oppressive. Moreover, in some instances, the pension plans themselves would bear the expenses. For example, Section 1112(d)(2) of S. 2105 would, under some circumstances, authorize the Board to retain accountants and actuaries on behalf of the participants in a pension plan and provides that "[t]he plan shall be liable to the Board for the expenses for any such audit or actuarial report." Thus PERISA would not only supplant the state's judgment as to how its employees' pension plan should be administered, but would interfere directly with the employer-employee relationship by imposing new costs both directly upon the states and upon the employees themselves.

While it may be argued that the PERISA requirements are similar to requirements already enacted for corporate pension plans, corporations are not organs of government. State and local governments are subject to the political process and will therefore be more responsive in protecting the pension rights of their employees than will many business corporations. In any event, the question is not whether the requirements of PERISA are so onerous that it would be impossible to comply or even whether the protections of state law will in all cases be adequate. The question is who has the right and responsibility to determine the rules governing the relationship between state governments and their employees. Under the Constitution, that duty lies with the states.

2. <u>PERISA Is Unconstitutional Under NLC Regardless of Its Impact Upon the States.</u>

The discussion above demonstrates that PERISA would fundamentally and dramatically affect the ability of the states to structure employer-employee relations. However, a detailed analysis of the impact of PERISA is not necessary to establish the unconstitutional character of such legislation.

In <u>NLC</u>, the Supreme Court cited a number of specific examples of programs and services that state and local government officials alleged would be curtailed or eliminated as a result of the increased costs imposed by the application of the Fair Labor Standards Act to the states. However, the Court carefully stated its basis for holding the act unconstitutional:

> <u>We do not believe particularized assessments of actual impact are crucial to resolution of the issue presented</u> .... For even if we accept appellee's assessments concerning the impact of the amendments, their application will nonetheless significantly alter or displace the States' abilities to structure employer-employee relationships in such areas as fire prevention, police protection, sanitation, public health, and parks and recreation .... <u>If Congress may withdraw from the States the authority to make those fundamental employment decisions upon which their systems for performance of these functions must rest, we think there would be little left of the States' "'separate and independent existence ....'"</u> [T]he dispositive factor is that Congress has attempted to exercise its Commerce Clause

> authority to prescribe minimum wages and maximum hours to be paid by the States in their capacities as sovereign governments.

Id. at 851-52 (emphasis added).

NLC attempts to protect the "indestructible union, composed of indestructible states." 426 U.S. at 844, quoting Texas v. White, 7 Wall 700, 725 (1869). In NLC, the Court was concerned with a subtle but insidious process -- that acts of Congress, perhaps in pursuit of laudable goals, would gradually eat away at the structure and substance of the states. Thus Congress might eventually erode the power of the states, until the states as the fundamental bedrock of our federal system could no longer be said to exist.

Any attempt by Congress to dictate to the states how they structure their employer-employee relationships is therefore constitutionally proscribed. Under PERISA, state pensions, a part of the basic compensation package agreed upon by the state and its employees, would become the subject of federal mandate. As did the Fair Labor Standards Act, PERISA would displace the states' abilities to structure employer-employee relationships. Furthermore, the impact of PERISA would be no less far-reaching than that of minimum wage requirements. Indeed, its effect might be even greater, since PERISA would include professional workers who were excluded from the statute challenged in NLC. 3/

3. Recent Decisions of Federal Courts of Appeal Indicate that Pension Plans Are of Vital Importance to the States' Governmental Functions and Are Protected by NLC.

Those federal Courts of Appeals that have considered analogous questions have had little hesitation in finding issues associated with pension rights within the ambit of NLC. In Pinemann v. Oechslin, 637 F.2d 1 (1981), the Second Circuit, after noting that state common law governing the vesting of public employee pension rights was in this case highly uncertain, stated:

> The subject matter, the fixing of compensation benefits to state employees, is of vital importance to the state and its governmental functioning.

637 F.2d at 606, citing NLC. 4/

3/ Executive, administrative, and professional workers are exempted from the minimum wage and maximum hour requirements of the Fair Labor Standards Act. 29 U.S.C. § 213(a)(1) (1976).

4/ Here, the Court of Appeals held that federal courts should abstain from deciding the case so that state courts could be given the opportunity to adjudicate aspects of the claims relating to state pension rights and state contract law.

In Cantwell v. County of San Mateo, 631 F.2d 631 (1980), the Ninth Circuit found that a federal statute governing retirement pay for reserve military personnel "affects the same state interests as in [NLC], i.e., the amount of compensation county employees receive (in this instance, in the form of pension benefits)." 631 F.2d at 636. 5/

PERISA is an attempt by Congress to exercise its commerce power in an area that is foreclosed to it by constitutional principles of federalism. It is plainly a "congressionally imposed displacement of state decisions [that] may substantially restructure traditional ways in which the local governments have arranged their affairs." NLC, 426 U.S. at 849. It is a direct attempt by Congress to regulate fundamental employment decisions made by the state. PERISA falls squarely within the rule of NLC and is unquestionably unconstitutional.

C. NLC Merely Reflects Historic Limitations Upon the Power of Congress.

The status of the states as independent sovereigns has been protected since the foundation of our republic. 6/ The Constitution contemplated a scheme of limited federal power:

5/ In Cantwell, the 9th Circuit held that the federal statute there under consideration was an exercise of Congressional authority under the war power clause of the Constitution; the Supreme Court specifically noted that in NLC nothing in its opinion addressed the scope of Congress's authority under its war power.

6/ As James Madison explained, advocating ratification of the Constitution:

[FOOTNOTE 6. CONTINUED ON NEXT PAGE]

> [T]he powers delegated ... to the federal government are few and defined. Those which are to remain in the state governments are numerous and indefinite .... The powers reserved to the several states will extend to all the objects which, in the ordinary course of affairs, concern the lives, liberties, and properties of the people, and the internal order, improvement, and prosperity of the state.

The Federalist No. 45 (J. Madison) (Cambridge Law Classics Library Ed. at 319).

The Founding Fathers certainly did not believe that the national government could constitutionally abridge these sovereign functions of the states. 7/ While this conclusion is "clearly

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[FOOTNOTE 6. CONTINUED FROM PREVIOUS PAGE]

> [T]he general government is not to be charged with the whole power of making and administering laws. Its jurisdiction is limited to certain enumerated objects, which concern all the members of the republic, but which are not to be attained by the separate provisions of any. The subordinate governments, which can extend their care to all those other subjects which can be separately provided for, will retain their due authority and activity. Were it proposed by the plan of the convention to abolish the governments of the particular states, its adversaries would have some ground for their objection ....

The Federalist No. 14 (J. Madison) IV Cambridge Law Classics Library Ed. at 92).

7/ To the contrary, the greater fear was that the states would be too strong under the Constitution. *See*, *e.g.*, The Federalist Nos. 17 (A. Hamilton), 31 (A. Hamilton), 46 (J. Madison). It was also argued that, in certain respects, state governments would be strengthened by adoption of the Constitution. *See* The Federalist No. 21 (A. Hamilton).

admitted by the whole tenor of the instrument which contains the articles of the ... Constitution," The Federalist No. 32 (A. Hamilton) (IV Cambridge Law Classics Library Ed. at 210), it is also buttressed by the tenth amendment, which was ratified as part of the Bill of Rights in 1791.

The Supreme Court has repeatedly reflected this view of the tenth amendment. In United States v. Darby, 312 U.S. 100 (1941), the Court observed that "[t]he amendment states but a truism that all is retained which has not been surrendered." Id. at 124. More recently, the Court pointed out that the amendment "is not without significance. [It] expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system." Fry v. United States, 421 U.S. 542, 547 n. 7 (1975). Finally, the Court cited this view of the amendment with approval in NLC. 426 U.S. at 842-43.

Decisions of the Supreme Court throughout our history have demonstrated the Court's concern that the authority of the states not be undercut. See, e.g., Erie R. Co. v. Tompkins, 304 U.S. 64 (1938) (requiring federal courts to apply state law except in matters governed by the Constitution or by acts of Congress); Fox Film Corp. v. Muller, 296 U.S. 207 (1935) (holding that the Supreme Court will not review a judgment of a state court which rests upon adequate and independent state grounds).

Thus, if Congress attempts to impair the sovereignty of the states by imposing PERISA upon the states or their employees, it will encounter constitutional limitations which have been respected since the foundation of the republic.

III. CONCLUSION

At a time when there is an increasing political awareness that the federal government has intruded in the affairs of the states beyond the point of wisdom, if not beyond the point of law, it is remarkable that Congress would contemplate passing legislation such as PERISA which is so clearly beyond the lawful scope of its powers. The courts stand as a last bastion to protect the states from unconstitutional intrusions by the federal government. But Congress has a shared obligation with the Courts to protect our constitutional values. Enactment of PERISA would run counter to the responsibility of Congress to uphold the Constitution of the United States.

Respectfully submitted,

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Senator CHAFEE. Thank you very much, Governor. Of course, we appreciate this excellent brief that you have submitted here, which you have just summarized. There will be some questions, I am sure.

Why do we not have Mr. Klausner proceed now?

STATEMENT OF ROBERT D. KLAUSNER, ESQUIRE, PELZNER, SCHWEDOCK, FINKELSTEIN & KLAUSNER, P.A.

Mr. KLAUSNER. Thank you, Senator. My name is Robert Klausner. I am from Miami, Fla.

Senator, I am here today as a private citizen and as one who deals every day in the problems of public employees and their pension systems.

Regarding the constitutional issues, I strongly disagree with the legal statements made by those who base their opposition to PERISA on the *National League of Cities* v. *Usery.*

Senator CHAFEE. Mr. Klausner, do you have a statement?

Mr. KLAUSNER. Yes, Senator. My statement was delivered here this morning.

Senator CHAFEE. All right. Fine. Now, you may work within the time limits.

Mr. KLAUSNER. Thank you. I think it is important enough to all the employees in the United States that I do come regarding the constitutional issues. The *National League of Cities* v. *Usery* case, since it has been handed down 6 years ago, has been very narrowly construed by the other Federal courts in this country.

The Equal Pay Act has been held not to be limited to the unemployment taxation, title VII, public accommodations, virtually every other Federal scheme regarding equal protection and civil rights has been held not affected by the *National League of Cities* case.

Quite simply, if the Federal Government cannot regulate the States in those areas where they have proven unwilling or unable to regulate themselves, then the problem will only continue further.

It is most interesting that we have had such strong exceptions and objections from the National League of Cities, the National Association of Counties, and the State Legislatures Association. In my opinion, I think the gentlemen doth protest too much. They have been proclaiming their innocence for so long that one wonders why they have to proclaim their innocence so loudly and so strongly.

I tell you that the reason, from my actual practice, is that there are serious, serious problems in these pension systems.

I began my legal career as a municipal attorney for the city of Miami and had the dubious distinction of being their pension attorney. I was responsible for giving legal advice to a plan whose unfunded liability exceeded the city's constitutional ability to tax to fulfill the contribution requirements.

I have seen other plans in Florida affecting thousands of employees that are tens of millions of dollars into the unfunded liability. I have seen the State's own retirement system, which is the worst offender of all, lumbering billions—billions—into the unfunded liability, far beyond the ability of the taxpayers to make it whole unless there is some dramatic change, and some dramatic change now.

As a personal preference, I prefer S. 2106 because of the strength it gives the fiduciaries. I found that to be the most serious problem: That the boards of trustees who have been governing these pensions have divided loyalties.

You put a city finance director on a pension, he has only so much money to deal with in a given budget year. There is a need for new fire trucks and a need to put more police officers on the street. Yet at the same time there is a need to make the annual contribution to the retirement system. One is an immediate need because the citizens are crying for protection. The other one seems a need that over an actuarial period of 35 or 40 years seems a problem that can be put off until tomorrow.

Well, unfortunately, tomorrow is starting to arrive in a lot of our cities and our counties and our States, and it is going to be too late soon.

The bill is hardly intrusive. It is a situation where it is like the person who gets a speeding ticket, and he says to the police officer, well, what about all those other people who were speeding? Well, if we took that attitude regarding things that are wrong, nothing would ever get fixed because you cannot fix them all at the same time.

If the Federal Government has problems, then it will be the Federal Government's responsibility to take care of them. The States have proven themselves unwilling and unable to solve the problem. The bill is needed now.

It is quite interesting, when I started coming up here 2 years ago, Florida's bill regarding public disclosure was touted as a model in the United States.

I notice its absence today in the comments of those in opposition to PERISA, the reason being because, I know from my own experience, that it is cosmetic, that it appeared to solve the problem, yet it left the same political attacks on the pensions. It failed to provide a reasonable disclosure. It failed to provide preretirement counseling.

I recently argued a case in Florida's Court of Appeals involving an $8 million underfunding in a municipal pension. The attorney for the municipality said, well, if the employees are not happy with the way we are running the system, let the individual employee sue us. What a waste of money.

That may be great for lawyers in their business, but it is not good for the participants and it is not good for the taxpayers.

PERISA is very much of a commonsense approach to the problem. If you see how the system is being run, if you give the fiduciary the strength necessary to run the program and provide a penalty for the wayward fiduciary and resist that temptation for misusing the funds, then I think the problem will ultimately be solved, then the States will be able to adopt a funding policy.

Quite frankly, I would prefer to see a funding policy in the bill, but I am realistic enough to know that that would only add to the problems here. That is simply a personal preference.

I think the bill, either S. 2105 or S. 2106, ultimately will be a major step in support of solving the problem. I am not here with a particular special interest to represent. I am here because I am a taxpayer and I am a citizen. I see that my own taxes are going up because the pension costs are getting out of hand, because 15 or 20 years ago someone said, let us put it off until 1982, and now someone is saying, let us put it off until the year 2002.

Well, the problem is, as the country grows older, the number of public employees is remaining static because cities are cutting back, yet the number of retirees is growing. Mine is a State of many retirees, and I see the problem. It is a national problem, because as they retire and move, they put taxation on their new homes.

In conclusion, I thank the committee for the opportunity to speak here, and I strongly urge your support for the bill.

[The statement of Mr. Klausner follows:]

Congress of the United States

United States Senate

Committee on Finance

Subcommittee on Savings, Pensions and

Investment Policy

Hearings on S-2105 and S-2106

March 29, 1982

Testimony

of

Robert D. Klausner, Esquire
28 West Flager Street
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Mr. Chairman, members of the Committee, I wish to thank you for the opportunity of addressing you today concerning S-2105 and 2106 . These bills, whichever may be adopted, constitute the first comprehensive effort to bring order and stability to the thousands of public employee retirement systems in the United States.

Given the difficult economic times, which our Nation is facing today, the security and integrity of public employee retirement systems takes on a new and unprecedented significance. Hundreds of thousands of loyal government employees have contributed their labor and their hard earned contributions to their respective retirement systems with the hope and expectation that those systems will provide them a well earned retirement, financial security and dignity. It is incumbent upon this Congress to take immediate steps to insure that the dreams of those government employees are fulfilled.

Before discussing the specifics of this Bill, I believe it is important for the members of this Committee to be aware of some of the tremendous injustices occurring throughout the United States as a result of the mismanagement of public employee retirement plans.

In the late 1960s to mid 1970s, the management of the City of Miami Retirement System was placed by that City's legislative body in the hands of a corporate trustee. Over that decade of management, the corporate trustee returned a net gain on the assets of the plan of less than 1%. At the same time, the number of retirees doubled and the number of active, contributing employees declined.

At the same time, this same governmental body so under funded its retirement systems that in 1974 the unfunded liability of the City of Miami's two retirement systems exceeded the City's legal ability to tax necessary contributions.

Throughout this entire period, the legislative body of that City failed to take any steps to remedy these abuses. In addition, the other demands of City government created a severe budgetary short fall. As a result, the retirement systems of the City received an even lower priority with regard to adequate funding. Actuarial studies purporting to reflect the needs of the plan coincidentally equalled the exact amount of money which the City Manager chose to allocate for pension purposes. At the end of this ten year decline into a quagmire of mismanagement, the City Commission finally turned control of the retirement system over to an independent board of trustees. Within the last seven years that board of trustees has significantly reduced the unfunded liability of the plan and has increased the investment performance of the fund by nearly 400%.

At the same time, this board of trustees reduced the number of retirees by instituting a vigorous program of re-examination of disability pension recipients and instituted a program offsetting disability retirement benefits against the monies received from workers' compensation funds.

After putting its own house in order, that board of trustees turned to the plan's sponsor and demanded that the funding policies of the past be permanently altered. Faced with further inaction, the board of trustees and the labor unions representing the City's employees, filed suit against the City to remedy continued funding short falls.

The response of the City was to legislatively abolish the board of trustees and seek to reinstitute the corporate trustee system. The thinly veiled purpose of this legislation was the hope of ending the litigation by legislatively abolishing the plaintiff.

After nearly two years of litigation, we are pleased to report that the City fathers have finally recognized the errors of their past action. Within the next month, it is hoped that the City will have fully funded its pension consistent with independent actuarial determinations.

At the same time, agreement has been reached on the establishment of a board of trustees, totally outside the control of the City Commission.

The credit for this turn about can be credited in part to the efforts of this Congress in attempting to move forward federal legislation in this area. If nothing else, the fear of federal intervention into the local government pension area has frightened complacent government officials into finally putting their retirement houses in good order.

The cornerstone of successful retirement system management on the local level is the establishment and maintenance of free and independent boards of trustees. Only when the persons managing a retirement system are free from conflicting duties and responsibilities, can they truly render the type of leadership needed to sustain an adequate retirement system in difficult economic times.

The two Bills being considered by this Committee obviously recognize the need for well defined fiduciary responsibilities on the part of retirement trustees. The public employees of Florida welcome this regulation and in fact would urge even stronger measures.

Public employees are acutely aware of the serious fiscal condition of many local government entities. Even cities in areas undergoing continued economic growth, such as South Florida, are being forced to lay off large numbers of employees.

Because of the increased demand in many communities for additional police and fire protection, a number of cities have made the hard choice to lay off clerical and social service employees in favor of additional fire and police personnel. The result of this activity has been an increased drain on existing municipal pension funds as a result of early retirement together with the increased cost of funding new employee benefits.

It is not now, nor has it ever been, the goal of public employees to force their government employers into financial ruin over retirement benefits. In fact, as recently as last month, the Supreme Court of Florida upheld a unilateral reduction in disability retirement benefits to State employees on the grounds of economic need. Such a harsh and drastic ruling only highlights the need for immediate regulation in the retirement field.

Local governments have proven themselves incapable or unwilling to properly manage public employee retirement benefits and as a result, the future lives of millions of Americans hang perilously in the balance.

Another severe problem existing in local government retirement fund administration is the practical inability of the designated trustees to administer the affairs of a plan without repeated interference from professional government staffers. Another example can be drawn from the major Metropolitan area in South Florida.

This particular municipality maintains two retirement systems for its employees and has adopted the use of employee boards of trustees for the day to day management of the plan. At the same time, however, professional staffers within the executive branch of the municipality maintain direct control over the clerical, administrative and legal services to the board of trustees. As a result, the board of trustees finds itself having to share a lawyer with a municipality and having its own employees directed by the employer.

The question to be asked is whether or not this is an inherently undesirable situation, as ultimately a significant portion of the fund comes from the governmental sponsor itself. Practical experience has conclusively demonstrated that this situation has reached an unacceptable level.

One of the most basic principles of the law of trusts is that the settlor or creator of a trust cannot also be the trustee. Since the ancient common law, trustees have been held to the very highest standards of conduct and may lawfully take only those acts which are necessary to protect the interests of the beneficiaries and participants of the trust.

This particular municipality as with many municipalities is faced with increasing costs of providing government services. In light of strong community sentiment against increased taxation, local government has found itself faced with a difficult choice of which services to provide and which to eliminate.

As most pension benefits are deferred into the future, it is an active inducement to government officials to ignore the requirements of the future in an effort to keep one's head above water in the present.

As a result, this municipality chose to delay the contribution of even the bare minimum funding dictated by actuarial recommendations. With the board of trustees and the City sharing the same law office, it was impossible for the board of trustees to take action necessary to enforce the contribution provisions of the trust agreement. Similarly, to prevent any administrative action, the City refused to release funds to the board of trustees to enable them to hire legal counsel. The foregoing incident is typical of the problems facing local government pension systems throughout the United States. Strong and immediate legislative remedies are needed to clarify the question of fudiciary power and responsibility in pension trustees. If this Congress fails to act to create a viable system of enforcement of contribution and investment responsibilities, the ultimate result can only be the failure of public retirement systems on an unprecedented scale.

I believe it is not too late to make a real difference in the future of America's public employee retirement systems. The mere threat of this legislation has encouraged a number of States and local governments to enact their own mini-PERISA Bills. Yet the value of threatened federal action is only a temporary incentive. The real problems facing our public employee retirement systems demand equally real and permanent legislative action.

The goal of this proposed legislation should be to permanently remove the control and management of public employee retirement systems from the political sphere. As the funding decisions for most public employee retirement systems are made by elected officials, it cannot be denied that political consequences play a significant role in the life or death of retirement systems.

State and local legislators are facing greater demands for services today than at any other time in history. In light of the recent decision by President Reagan to return large numbers of federal programs to the States, the pressure on local government officials can only increase.

Today's State or local government official is faced with a difficult choice of meeting increased demands for social services from a population desperate for property tax relief. At the same time, the needs of their retirement systems continue to grow as greater numbers of employees join the ranks of the retired.

The obvious result is that priorities must be established. It is hoped that the adoption of this legislation will ensure that the retirement needs of the public employees will maintain some consistency in that priority of funding. Having been a local government attorney directly involved with the management of a pension system, I have a personal appreciation for the difficulty of the task and the temptation for the easy solution.

Another area of substantial concern has been the consistent lack of pre-retirement counselling for public employees. Most government personnel approach retirement with little or no thought to the financial ramifications of their soon to be established life style.

The typical scenario is for an employee of 25 years standing to place his or her application for retirement and then be presented with the need of choosing among six or seven options for payment of retirement benefits. Only the most sophisticated employee can adequately analyze and determine which retirement option best fits the needs of his or her family situation.

I commend the draftors of this legislation for their personal commitment to a comprehensive program of pre-retirement counselling. Of those local governments that have adopted pension reform legislation, this counselling area continues to be surprisingly absent from any legislative plan. All the disclosure requirements in the world are meaningless unless structured in such a fashion that the average employee can intelligently and knowingly decide what future course his or her life should take. In speaking to several meetings and seminars for municipal pension trustees in Florida, I have heard a number of comments and concerns raised regarding the reporting and disclosure requirements proposed in the Bills before this Committee. The fear most often voiced was that in those States which have recently adopted improved reporting and disclosure requirements, that an additional layer of bureaucracy and reporting would be required to meet the proposed federal guidelines.

Again, the drafters of this legislation are to be commended for providing alternative methods of reporting and exemptions for those States and local governments which have adopted their own reporting and disclosure systems.

One caveat exists, however. The individual reporting and disclosure requirements adopted by various States and local government bodies must be carefully scrutinized to ensure that they are consistent with the proposed federal legislation. The manner in which exemptions from PERISA reporting requirements are granted will have a substantial effect on the effectiveness of this legislation. It would be preferable for all local governments to follow the same system of reporting so that the information is more easily collected and more readily available for comparative study among the various States. Ultimately the most serious problem with local government retirement systems is funding.

Experience has proven time and again that reporting and disclosure provisions alone while increasing participant awareness of the condition of their retirement system, is insufficient to ensure sound pension management. Unless there is a requirement that public employee retirement systems adopt a definitive funding policy, the battle to enforce adequate contributions and investment policies will undoubtedly continue.

The proposed Bills contain some very impressive enforcement provisions. They also contain model provisions for the establishment of actuarial determinations and implementation of the uniform accounting procedures. Again, it is my opinion that the legislation stops short of needed funding guidelines. In failing to establish minimum funding policies, the Bills ignore the practical fact that many pension fudiciaries do not have control over the public purse strings so as to ensure that their contributions are timely and properly made without resort to assistance from the judicial branch of government. I have been involved, and continue to be involved, in a number of legal actions involving adequacy of pension funding. Because there is no requirement for the establishment of a minimum funding standard, an impermissible degree of discretion has been left with local government officials regarding the adequacy and timeliness of their contributions.

The real tragedy in all of this is that monies so desperately needed for pension contributions are being expended in legal fees and court costs to defend some abstract principle of local government autonomy. It would be a far more constructive use of the taxpayers money to make regular and timely contributions so that a consistent investment policy may be followed rather than seek to delay for as long as possible the payment of necessary contributions in an effort to avoid the inevitable consequences of retirement needs. Similarly, employees are forced to part with their hard earned money to support legal fees for their various Unions and labor representatives in order to continue these legal battles. If the rules of the game were more clearly defined, then the players could spend more time developing their skills at pension investment and administration, than arguing about how the game should be played in the first place.

If it is truly the intent of this body to bring some order to the house of pension and retirement, then a sound funding policy must be an integral part of that foundation.

Since the first time PERISA was discussed, serious questions of constitutionality have been raised, particularly by State and local government officials.

Invariably, government attorneys point to the decision of the United States Supreme Court in the National League of Cities case for the principle that the federal government has no business regulating local government's financial affairs.

In maintaining such a narrow view, these same officials forget that if they abdicate their responsibility to their own employees, then the burden will invariably fall upon all of the tax payers of the nation.

We are continuously increasing the tax upon ourselves to support a social security system whose benefits have grown far faster than its rate of contribution. The tax payers of this nation cannot also afford to again dip into their pockets to remedy unnecessary mismanagement of their own local government retirement systems.

Unquestionably some degree of local sovereignty is sacrificed whenever the federal government pre-empts unto itself a field of regulation traditionally reserved to the States. The great reluctance of the Congress to take such a step in the local government retirement area is reflected in the fact that PERISA is still a long way from becoming the law of the land. As a former government attorney, and now as an active private practitioner in the area of Administrative and Governmental Law, I firmly believe that any constitutional challeges to PERISA can be over come. A substantial factor in support of federal regulation in the field is the fact that the home rule approach has been a drastic failure.

Our nation has become increasingly inter-dependent and the dramatic shifts in population from one area of the Country to another are expected to continue at an increasing rate. As a result, traditional concepts of the local community have changed as well.

Florida is a prime example of the change in concept of retirement in America. A substantial portion of the population growth in our State is due to a rapid influx of retirees from the north east and north central States. Should their own local government retirement benefits prove inadequate, they will invariably turn to their new home State for assistance. Again, the "New Federalism" as espoused by the present administration will be placing an increasing responsibility on State government for social and welfare programs. Unless the federal government acts to create stability in the basic retirement systems, no State government will be able to bear the economic consequences.

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It is my belief that the exemption provisions for States with their own mini-PERISA Bills, is more than sufficient to satisfy any claim of unconstitutional dilution of State's rights. Whatever erosion of those local rights occurs, from the enactment of either of these proposed Bills, is far out-weighed by the disastrous consequences to millions of Americans should they be denied their retirement benefits for which they have so diligently worked and contributed.

In examining the Bills themselves, I have a number of specific concerns which I wish to call to the attention of this Committee.

Beginning with the Sections providing an exemption from the reporting and disclosure requirements of PERISA for States with their own similar legislation, an important distinction exists between the two Bills.

S-2106 provides the Secretary of Labor with the power to determine when an exemption shall exist. By contrast, S-2105 leaves a large part of the determination to the Governor of the State in which the particular plan is located.

Personal experience leads me to prefer leaving that determination to the Secretary of Labor. One of the significant goals of PERISA, as earlier stated, is to remove the retirement systems from the political sphere. Leaving that certification to a local official increases the possibility that reporting and disclosure guidelines will not be strictly enforced.

Regarding the plain language requirement for summary plan description, I commend the draftors of both Bills for this important regulation. Virtually every State has passed legislation requiring insurance companies to provide plain language summaries to policyholders. Similarly, a number of Courts are admonishing lawyers to eliminate archaic terms from their pleadings and streamline legal documents.

It, therefore, follows that a true understanding of retirement benefits by participants and beneficiaries is dependent upon pension legislation being distributed in an understandable and reasily useable fashion. Reporting and disclosure requirements are to no avail if the beneficiaries of those plans are not able to inquire as to the scope and quality of their benefits. The better informed the participants of a retirement system are, the more accountable pension managers will remain.

The provisions relating to the appointment of an independent certified public accountant for the purposes of the annual financial statement have an even greater significance than may be realized by certain members of the Committee.

Traditionally, the in-house finance department in each of the sponsoring agencies has been the body that performed the annual financial audit. Invariably, that department was under the direction of the local finance or budget director whose loyalty to the retirement plan was severely complicated by additional loyalties to the other fiscal needs of the public employer.

In permitting an audit agency of the State or political subdivision of a State to conduct the independent accounting functions under the proposed Bills, it still leaves the possibility of interference open. It is my belief that an independent accountant must be someone who is totally outside of government and who must also refrain from any accounting activities on behalf of the plan sponsor during the remainder of the year.

In one South Florida city, the outside city auditor also performed the audit on the city's retirement plan. The outside auditor was, however, directed in his efforts by the City's Finance Director. Because of continuing tensions between the Board of Trustees and the City Finance Director, over the amount of monies to be contributed to the fund, this so called independent auditor found himself caught between a duty to the pension trust and the implied sense of loyalty to the person who was actually his employer. It is exactly these types of conflicts which PERISA must eliminate. In essence, the Independent Accountant is to be a watch dog who does not himself need to be watched.

I commend the drafters of both bills regarding the insertion of the provision providing for a report of Insurance Organization to be included in the Annual Plan Statement. A large number of the smaller City plans are entirely invested in insurance contracts. To many of these Trustees have failed to take a direct interest in the investment performance of the Insurance Companies preferring to rely upon somewhat nebulous assurances of good performance.

An examination of the insurance performance is particularly important in those plans where the sponsoring Insurance Company does not maintain separate experience records.

I recently participated in the conversion of a small South Florida City's Pension Fund from an Insurance Program to a Trustee run investment system. While the Insurance Company could not pinpoint the specific experience of the Fund, it seemed to have no difficulty in determining what substantial degree of discount was necessary in order liquidate the bonds in which the Pension System's funds were invested. Again, only the threat of costly litigation caused the matter to be resolved in an acceptable fashion.

The provisions relating to information to be provided to participants and beneficiaries are most important in the area of pre-retirement counseling. By making such counseling mandatory, upon the withdrawal of contributions or benefits, prospective retirees will be forced to make a necessary assessment of their individual financial needs. Since most local government plans make the selection of a retirement option an irrevocable decision, mandatory pre-retirement counseling becomes even more important. Should this provision become law, the rule making regarding plain language explanations of retirement options will be extremely important in ensuring the vitality of this provision.

The sections relating to the filing of annual reports and the action which may be taken to enforce that provision raises an interesting question of financial responsibility. It appears in both Bills that the plan will bear the cost of any mandatory accounting actuarial or legal services which the Board or Secretary will have to undertake to ensure timely filing of annual reports. Yet in taxing such costs against the plan, the persons who are in effect injured are the participants and beneficiaries of that plan. Perhaps attaching some liability directly to the officials responsible for said delays will encourage swift and complete compliance with filing requirements.

The provisions relating to the establishment of a Pension Trust raise an interesting constitutional question. Both Bills provide that upon acceptance of being named or appointed as a Trustee, said Trustee shall have exclusive authority and discretion to manage and control the assets of the plan. It could be argued if such a procedure is intended to establish irrevocable Pension Trusts. The constitutional argument arises from the fact that States and their Political Subdivisions would claim that the Federal Government has usurped their inherent legislative power to create and destroy subordinate governmental bodies. While this is a compelling State's rights argument, its adoption would render futile any real integrity to a Pension Trust.

While Congress cannot mandate that a State maintain a retirement system which ultimately will bankrupt it, I believe that it does have the power to limit a State's right to render impotent the power of its Pension Managers and Administrators. If State and local governments are serious about rectifying their present pension problems, they must be willing to surrender a certain degree of autonomy to Pension Boards of Trustees in order that the pension systems might flourish free from unwarranted interference.

I am most pleased with the strong language provided in those sections of the Bill relating to fudiciary functions and responsibilities. Far too few retirement systems expressly state the duties and responsibilities of their named fiduciaries. The present language set forth in these proposed Bills leaves no doubt as to where the duty of loyalty lies for a pension fudiciary. Such clearly delineated standards will enhance the ability of Pension Boards of Trustees to take strong action against recalcitrant employers for inadequate or untimely contributions. Similarly, such a high standard of conduct and personal liability will serve to deter less dedicated persons from services pension fiduciaries. The two proposed Bills express a difference in philosophy concerning the ability of a retirement system to invest in securities or real property of the plan's sponsor. Because of past experience in this area, I recommend that the Committee adopt the more restrictive 5% limitation.

There is also a difference in approach concerning liability for failure to meet the requirements related to fiduciary functions. S-2106 creates a higher standard than does Bill 2105, in that the former places liability on any person who fails to meet any of the requirements imposed upon fiduciaries, whereas the latter employs language implying the need for a higher degree of intentional culpability. In my opinion, the more restrictive language is desirable.

One of the most interesting constitutional issues arises with reference to the provision regarding actions of government officials which are not considered fiduciary duties. In providing this exception, local government officials are presented with an extremely large loophole in which to frustrate the very purposes of PERISA. At the same time, the elimination of this provision would present serious constitutional problems of unwarranted intrusion by the Federal Government into powers traditionally reserved to the States. In most of the public employees retirement plans which I have had dealings, the persons serving as fiduciaries are invariably government officials of different responsibilities. For example, most of the public employee plans on the municipal level in Florida include the City's Finance Director as a fiduciary. That individual often finds himself or herself in the unenviable position of choosing between responsibilities of the Pension Trustee and those of the Finance Director with a limited budget. If that person, however, is relieved of fiduciary duty because of the holding of that government office, there can be little or no integrity in the fiduciary process. Either the act must exclude such persons with an inherent conflict from participation as fiduciaries or the exceptions provided in Section 214 must be removed. As an example of the inherent problems, a major South Florida retirement system mandates by Ordinance that the Finance Director and the Director of Budget and Management be appointed as fiduciaries of the Pension Trust. Through several of those appointments, there has been a consistent pattern of urging the least conservative funding policy in an effort to lower the employer contribution. The actions of these individuals is certainly understandable in light of the conflicting responsibilities of local government finance officers. This, however, is not the problem that this Congress needs to address. If Pension and Retirement Benefits are more generous than the municipality can afford, then that must be addressed to the Collective Bargaining Table. Once benefits are granted, underfunding those benefits or not funding them at all is hardly the answer.

The presence of those particular provisions (Section 214 and Section 1214) is going to require tremendous act of good faith on behalf of local officials. By wrapping themselves in the cloak of legislative or governmental immunity, public officials will still have the apparent power to circumvent the noble purposes of this legislation. I strongly urge this Committee to investigate more carefully a narrowing of this exception consistent with the reservation of power inherent in the States.

A similar constitutional question is raised regarding the power given to retirement plans to sue and/or be sued as an entity.

Most public employee plans are created pursuant to Acts of the State legislature, municipal or county charter, or local ordinance. As such, the creating legislative body generally reserves unto itself the right to abolish or amend the plan at any time. Further, many State and local governments regard their Pension Board of Trustees as subordinate bodies of the plan's sponsor without any independent power or existence.

The recognition in these proposed Bills that plans may sue or be sued as an entity is in my opinion the only appropriate method by which a Pension Plan can maintain any semblance of independence. The conflict of law question, however, is not an insignificant one.

Specifically, in giving retirement plans statuses as legal entities, it might be argued that Congress is usurping the power of the States in their political subdivisions to determine their own particular form of government. The Act must contain a Congressional finding that the creation of independent plans is essential to the fulfillment of the Federal and National objectives which are at the heart of this legisla tion. Only a clear expression of Congressional intent to remove retirement plans from capricious local government action will suffice to eliminate legal challenges which are sure to arise. This then returns us to the issue which I raised earlier regarding a local government's inherent right to abolish a Board which it has created. I have already described a real situation in South Florida wherein a municipal legislative body sought to abolish the Pension Board of Trustees in an effort to eliminate an impending judgment for damages for failure to make proper contributions to the pension systems.

If these Bills are adopted in their present form, the question remains unanswered as to whether or not a plan will continue to exist for the purposes of this act even if that plan is amended or abolished under the terms of the sponsoring ordinance. The proposals before this Committee do not definitively answer that question. I urge the drafters of this legislation to add a definitive statement providing continued access to the Federal Courts under this Act for a retirement plan fiduciary notwithstanding any similar action by the local plan's sponsor. While the civil enforcement provisions in the proposed Bills more than adequately establishes access to the Courts, the absence of funding guidelines severely restricts the relief to be achieved against the delinquent plan 's sponsor.

If this legislation were to require the adoption and adherence to a definitive funding policy, there would be a great deal more for a Board of Trustees to enforce. The civil enforcement provisions of these Bills relate only to violations of the Act. As funding requirements are absent from the Act, no relief may be had for inadequate financing activities.

Nothing is more deleterious to the vitality of a pension system than the failure to make regular and timely contributions. Payment of those monies can only be insured when both the plan sponsor and the plan administrators have an established guideline for funding the needs of the system. I strongly urge this Committee to consider the addition of funding guidelines to this legislation. The absence of such a provision leaves a substantial gap in the circle of hope created by the promise of this pending legislation. Lastly, a philosophical decision needs to be made as to whether the Secretary of Labor shall be responsible for overseeing these laws or whether there shall be established an employee benefit administration. Cogent arguments can be made on both sides. In favor of the Secretary of Labor, it can be argued that additional Federal bureaucracy will not need to be established. The Labor Department is already geared for handling private sector PERISA compliance matters. It would merely be a matter of additional personnel to review the less complicated public employee reports.

In the alternative, the establishment of an employee benefit administration would remove regulation and rule making from a sole political appointee. As Cabinet Secretaries change with each Presidential Administration, it may desirous to have a Quasi Independent Board with definite terms of office.

Whichever method of oversight for PERISA is ultimately choosen, its really not the primary concern of the public employees that this Bill is designed to aid.

Rather, the sponsors of these Bills are taking a bold step to rectify decades of abuse and neglect in State and local government retirement systems. Public employees everywhere applaud the courage of your convictions and urge you not to give up the fight for this worthy legislation.

The amount and types of benefits that a State or local government gives to its employees is strictly a matter of local concern. It is a subject which is properly part of the Collective Bargaining process, in the public sector just as it is in the private sector. Once those funds are transferred to a retirement system, however, they become of irrevocable national concern.

Our nation's urban areas are crying out for additional public services and protections. As traditionally federal programs are transferred back to the States, the importance of local government will dramatically increase.

As a result, it is essential that the best and the brightest be encouraged to join and remain in the ranks of government servants. Generous retirement benefits have long been the greatest inducement to individuals in return for a life time of government service. State and local governments cannot often compete with the salaries offered in the private sector and as such, have used the retirement benefit as a counter balance. Today, that counter balance is threatened by the mismanagement of those retirement funds.

A year and a half ago, I told this Committee that the passage of a regulatory Bill for State and local government retirement systems would markedly improve the conditions of those retirement systems. The mere threat of this legislation passing through the Congress has already encouraged a number of States to pass local reporting and disclosure Bills. Yet these first steps are not enough.

Experience has shown that the plans under the control of independent fiduciaries consistently register the highest return on investments and maintain the lowest levels of unfunded liability. More importantly, efficient management of Pension assets will in the long run reduce the need for excess contributions by the employer.

The claims that this Bill will be overly intrusive in the areas of reporting and disclosure I believe are groundless. Care will be necessary in the rule making process so that the spirit of disclosure is not lost through over regulation.

I came before this Committee in October of 1980 to urge you in the strongest terms to pass this legislation.

Since that time, I have had the opportunity to talk with literally thousands of public employees and Pension Plan Administrators all over the South. They are nearly unanimous in their belief that a uniform system of reporting and disclosure can only benefit the national goal of retirement based upon financial security and dignity.

As a nation, we are growing older. The Social Security System was never designed nor will it ever be sufficient in and of itself to meet the retirement needs of most individuals. A large sector of our population devotes its working life time to government service. We owe them nothing less than the secure retirement we promised them as an inducement to their initial employment.

As a former government attorney, as a labor lawyer, and as a private citizen I again urge this Committee to push this legislation forward. As with any new project, there will invariably be problems and I have no doubt that some legislative fine tuning will be required as the process develops.

But one thing remains certain; that is, without legislation such as what is before this Committee today, the future of America's public employees retirement systems is gravely uncertain. Every new endeavor has its risks. In the case of pension and retirement systems, however, the risk of inaction is far greater.

I thank this Committee for permitting me the privilege of addressing it today and sharing the experiences of thousands of public employees in the State of Florida. I bring you their greetings and best wishes along with their fervent hope that this type of legislation will not be long in coming.

If I may be of any service to this Committee or its members in securing the passage of this Bill, I hope that you will not hesitate to call upon me. The steps that you take this year regarding the S-2105 and 2106 will shape the future for millions of American public employees and may well determine the quality of their lives in their future retirement.

Thank you.

Senator CHAFEE. Thank you very much, Mr. Klausner.
Mr. Schotland.

STATEMENT OF ROY A. SCHOTLAND, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. SCHOTLAND. Thank you, Senator.

This bill is not counter to the New Federalism, and I assume you introduced it because you know it is not. You know that it furthers the New Federalism, lest once again the worst part of the old federalism continue.

The first hearings conducted in the House on PERISA in 1975 found one of the first witnesses, the Secretary for Community Affairs for the State of Pennsylvania, explaining that the Feds should pick up the costs of certain Pennsylvania pensions.

Now, the reason this bill furthers the New Federalism is that the disclosure requirements will enable people in the States and localities to know what is happening in their pension funds. There is a deep lack of understanding, and local political processes cannot operate until the information is out.

I had a wonderful month in Hawaii last summer, and I had occasion to chat about pensions, during vacation, with some of Governor Ariyoshi's staff. I learned——

Senator CHAFEE. What a way to spend your vacation. [Laughter.] A lovely place. But the subject is unusual.

Mr. SCHOTLAND. Well, it was at a wonderful Japanese prefecture reunion that we were chatting about this. So if you have to talk about pensions, there are not better places.

Senator CHAFEE. You will not lose any points describing a vacation in Hawaii in this committee, I can tell you. [Laughter.]

Mr. SCHOTLAND. The reason I raised it is that there had been some problems just 1 year ago, as the Senator doubtless remembers better than I, in which it was thought that another session of the State legislature might be required because some problems had not been noticed in the enactment of the budget bill.

One of the problems was said to be that the pension fund was not being adequately funded. A press release was put out by somebody who I hope should have known better, saying, there is no problem of lack of money in the pension fund, we are just going to raise the actuarial assumption; not only will that take care of the pension fund problem, that is going to reduce the State deficit.

Well, that is Mickey Mouse, that is mirrors. We need to get the real information out. The people opposing this bill, whatever the ground, are ignoring the Federal interest which this committee sits to protect: The fiscal interest.

I noted in that first testimony, when New York City deviated from normal investment practices, it came to this committee and the Ways and Means Committee to get an exemption from the Internal Revenue Code.

Since 1937 the Federal involvement has been here. If the proposition is that the States ought to be free of the Federal involvement, that is fine so long as they will give up the favorable tax treatment that enables them to put the contributions in without there being current income to the employees. You sit to protect that favorable tax treatment from abuse in one fashion or another.

The best form of Federal involvement is precisely the disclosure route. One of the things that is being ignored today, this morning here, under the facade of everybody's agreeing that there is a terrible problem out there, are the facts about what is out there.

When Michael Thome, of the California Public Plans, testified before the House side, he noted that MFOA, an organization he was then testifying for, opposing this bill, had brought out some report about reporting and disclosure in the State plans. His whole statement was devoted to disclosure and reporting in State plans. He just somehow ignored the conclusion that the MFOA study came to, that reporting today is inadequate and confused and clearly in need of repair.

Purvis Collins, in the same hearing, on behalf of the National Council of Teacher Retirement, also opposing, quoted from a Rand Corp. study. He ignored the statements in the Rand Corp. study that little is known about teacher retirement system financial condition, aside from serious data deficiencies, and so forth.

They were getting data for that Rand study on teacher retirement systems in 1978. Two systems had nothing later than 1974. One of them happens to be New York City, whose witness was in here saying what a fine job is being done. This was 1978. Six systems, the latest data they could produce was 1975. Fifteen systems, the latest was 1976.

I went through recently a National Association of Retirement Administrators survey of 50 States, three territories; 33 of them, reporting on simply the earnings on investments, gave 10 different periods and 30 different definitions of earnings, from 33 respondents.

The NEA survey of 64 teachers funds, including some city funds, suffered as severe a babble of responses on the simple question, rate of return.

We need coordinated information. Without coordinated information, somebody sitting in Ohio, Hawaii, or Rhode Island cannot even figure out how his own system is doing because he cannot compare it with anything else.

Effective disclosure will activate local political processes. Disclosure cannot be effective unless you have comparable data—that is what we have had since 1933 in private securities markets, that is what we have got to have some of here. Only the Federal Government can assure comparability. A point too much ignored: Required disclosure is the least intrusive and least costly form of Federal Government intervention to protect the acute Federal interest.

Now, I have appended—tonight happens to be the Oscar Awards, and I have been looking at State and local disclosure long enough that I decided instead of just saying what a problem it is, I ought to try to draw attention to good disclosure. So a year and a half ago and again a few months ago I gave out awards for good State pension fund disclosure. I cannot compete with the Oscars unless I have a good name. Some cynics would say I cannot compete even then.

So I came up with the only—obviously, only—name for good disclosure: The Godiva award. I list in the latter part of my testimony the Godivas given in each of the last 2 years. Also the new Oscar the Grouch awards for stunningly bad disclosure, although I have not yet revealed the names of the recipients. A Mickey Mouse award to the State of California's comptroller for disclosure that looks good but is not.

Let me close by saying that the current fiscal stringency is such, and pension funding is such, that one of the easiest ways to avoid picking up current bills is the pension area. We are already doing it in capital improvements, which we have cut back tremendously, and we are going to be regressing in the pension area. The States and localities just do not have the money. They have got to balance their budgets. They are bound to cut here.

In short, for the bills you are considering, the impact of the fiscal distress right now is plain, never have we so much needed this legislation. Thank you.

[The statement of Mr. Schotland follows:]

Statement of Roy A. Schotland
Professor of Law
Georgetown University

March 29, 1982

HEARINGS on S. 2105 AND 2106, TO PROVIDE FOR PENSION REFORM FOR STATE AND LOCAL PUBLIC EMPLOYEE RETIREMENT SYSTEMS

Committee on Finance
U.S. Senate

Summary

* * * * *

It is a particular privilege to participate in this first Senate hearing on PERISA. Having been in the 1975 House Hearings; having helped open their 1978 Hearings in Wheaton, Illinois; having had that 1978 testimony specially inserted by Congressman Erlenborn in their 1980 Hearings (see pp. 226-235 of those Hearings), and having testified again on that side in February, I hope you agree that today it is better for me not to repeat the analyses, Constitutional considerations and abusive practices I set forth before. Rather, I will try to add new factual material showing the need for PERISA.

I take special pleasure in beginning by saying that I believe the crux of the entire 1,726 pages of the 1980 House Hearings was captured by Congressman Erlenborn at the very outset of that Hearing: from the first page of the first witness' testimony (Cong. Walgren's), Congressman Erlenborn pointed to this:

> "We as taxpayers need to know that pension plan assets are being invested prudently with the exclusive purpose

> of providing benefits to the beneficiaries of the pension plan." (1980 Hearings, at 136)

That statement points up the key need for PERISA:

> That local taxpayers must be informed, so that local political processes can operate to assure that pension assets are well-managed, so that their governments' pension promises will be honored, without turning for aid to the pension insurer of last resort: the Federal taxpayer.

The Federal involvement in state and local pension funds came out in the House's very first Hearings, when one of the first witnesses, Pennsylvania's Secretary of Community Affairs, suggested that the Federal Government pay for a veterans' benefit portion of Pennsylvania pensions (see the exchange with Cong. Erlenborn, 1975 Hearings at 106-7).

The Federal involvement took concrete form only months after your first Hearing, when New York City was aided by Federal guarantees for local pension funds' investments in employer securities, and temporary, limited exemption from Internal Revenue Code provisions which safeguard against diversion of tax-favored pension assets.

The most recent Federal involvement arose only this past autumn when those same IRC provisions were used to help defend the Detroit city pension funds from improper terms in a $56 million dollar transaction to aid the city, for which IRS approval was sought and secured.

Effective public disclosure about how public pension assets --roughly $225 billion as of end-1981--are being managed, is the most important first step toward protecting the Federal interest by assuring responsibility in state and local pensions. More, it is the most appropriate Federal step for four reasons:

1. Effective disclosure activates local political processes, so that pension problems are more likely to be worked out at home.

2. Disclosure cannot be effective unless local taxpayers and pension participants can compare how their funds are doing, relative to other similar funds.

3. Only the Federal Government can assure comparability of information about pension plans.

4. Required disclosure is the least intrusive and least costly form of regulation. This makes it especially appropriate when, as here, the Federal Government must take some steps affecting state and local governments in order to protect the Federal taxpayers' vulnerability as pension insurer of last resort.

A 1980 survey of state and local pension systems' financial disclosure, by MFOA under HUD grant, came to a clear conclusion (especially significant considering the source):

> "[A]vailable information indicates such reporting is today inadequate and confused and clearly in need of repair. Several factors contribute to the lack of good disclosure about [state and local] pension systems . . ." (John Petersen, Public Pension System Financial Disclosure, May 1980, at 3).

And what did MFOA point to as Cause #1 responsible for the poor state of disclosure? "Lack of general authoritative standards for system disclosure and of enforcement of such standards that do exist." (Ibid.)

How striking that last month, when Michael Thome of the California public plans testified on behalf of the MFOA and opposed PERISA, he only noted that MFOA's research arm had recently studied "the reporting and disclosure practices of state and local public employee retirement systems." He said nothing further about that study, although the bulk of his statement did deal with reporting and disclosure. My own substantial review of all reports publicly available for several years from over 30 states' pension systems (as well as from a number of local systems), convinces me that the MFOA study conclusion is clearly correct, "reporting is today inadequate and confused and clearly in need of repair," to quote MFOA.

The sad current state of disclosure about these plans is perfectly portrayed by another 1980 study also referred to, also incompletely, and also by a witness opposing the bills at the House's February hearing. Purvis Collins, on behalf of the National Council on Teacher Retirement, quoted from a Rand Corporation study of teacher retirement systems done for the National Institute of Education. He left out the fact that that study said repeatedly, as on its first page:

> "Assessing teacher retirement system financial condition, although conceptually straight-forward, presents may difficult empirical problems. Aside from serious data deficiencies, the difficulty of projecting . . . ." (P. v.)

> "Unfortunately, little is known about teacher retirement system financial condition. (P. 2)

The Rand study noted that "The degree of detail varied considerably between systems" (p. 39), and how very striking was this hurdle they faced in gathering data: Rand studied 60 teacher retirement systems, including 14 local systems. Consider how out-of-date, let alone non-comparable, were many of the data they were able to secure--they gathered data during 1978:

1974 data:	2 systems	(NYC and NY)
1975 " :	6	"
1976 " :	15	"
1977 " :	24	"
1978 " :	13	"

Without comparable data, it is vastly harder to use even the fullest data available to even a system's own officials, let alone public data available to participants and taxpayers.

In February 1981, the National Governors' Ass'n. Subcommittee on Public Retirement Systems under Gov. Ariyoshi of Hawaii, listed improved financial disclosure as the top priority in state and local pension reform.

With such a recommendation from the Governors, such a conclusion from MFOA, such a showing by Rand, how seriously can we take any objection to PERISA disclosure requirements?

Bringing the point right up-to-date: on January 12 the Illinois Study Commission on Public Pension Investment Policies found in its interim report that the State systems' method of disclosing investment performance--

> "is misleading and inconsistent with the way investors and performance evaluation firms measure investment performance." (BNA Pension Reporter, 25/1/82, p. 117.)

Before I close with examples of good and bad state and local pension disclosure, I must report a fine forthcoming event: within weeks, we will have comparative investment performance data on the 1980 equity and debt portfolios of more state pension funds than have ever before disclosed comparable data. By this summer, we should have even fuller data from the same important group, on 1981 performance. This effort, headed by Ms. Frances Crimbly, Pennsylvania State Employees' Retirement System Chief Investment Officer, is not only a valuable advance beyond the public fund data already available from several services (e.g., Becker, Merrill Lynch and InData) but the new survey is remarkably ahead of the biennial surveys by Nat'l. Ass'n. of State Retirement Administrators (NASRA) and by NEA. A while back I looked at a NASRA survey of 50 States and 3 territories: on one key item, "interest earnings on total investments," the 33 funds responding to that question reported not on one common period but on 10 different ones, and responded not to the precise question asked but instead gave figures pursuant to their own definitions--30 different definitions for the 33 respondents! The NEA survey of 64 teachers' funds (including some cities' funds) suffered almost as severe a babel of responses on even the key financial question, "rate of return of the portfolio in the past year."

The existing babel and gaps in state and local pension disclosure will end and disclosure will work, only if it is coordinated. Reposing responsibility for the effectiveness of that disclosure in the Labor Department, as S. 2106 does, is far better than risking a self-defeating law, one which risks losing comparability of data because each State could certify its own compliance with PERISA.

Two specific suggestions: Clearly questionable is the bills' allowing as much as 10% or 5% of assets for acquisition of employer securities, other employer obligations, and employer real property. It is important to remember what Congressman Erlenborn said about the origin of the 10% figure:

> "We were tracking ERISA in making that 10-percent limitation. I am not certain we perceived the trap we were falling into. I know that I didn't believe we might be inviting investment in the employer's securities . . . . We ought not to entice them into making such investments.
>
> "I suppose it could be argued that the exclusive benefit provision of the Internal Revenue Code also prohibits such investments. But the enactment of this may color the judgment as to the interpretation of the exclusive benefit Internal Revenue provisions."

(1978 Hearings, at p. 140.)

Also, it is important to remember that ERISA faced a vastly different situation with respect to corporate pension plans' holdings of sponsor securities and property: before 1975, many plans had much more than 10% of assets so invested. In contrast, consider the facts on state and local plans' holdings:

State and Local Government Employee Retirement Funds

Year	% of Assets in <u>State & Local Obligs.</u>	% <u>without</u> NYC funds' <u>holdings of S. & L. Obligs.*</u>
1960	4.4%	n.a.
62	3.8%	n.a.
64	2.9%	n.a.
1973	1.7%	n.a.
74	1.0%	n.a.
75	1.9%	1.3%
76	3.4%	1.8%
77	3.5%	1.3%
78	4.0%	1.8%
79	3.9%	1.9%
1980	4.1%	2.4%

(Source: Federal Reserve Board, Flow of Funds--Assets and Liabilities Outstanding, 1957-80, and IV/81)

* (Based on NYC data from Feb. 8 PERISA House Hearing testimony of Bernard Rosen, Assoc. Div., NYC OMB, Supplemental Data p. 1.)

In light of these facts about 20 years' practice, how justify even a 5% figure, let alone 10%? (The omitted years, like 1961 and 1965-72, had figures which simply continued the improvement reflected here.) Situations like New York City's--or the Detroit city funds' far smaller problem--can be handled exactly as those were handled, by special exception. But to provide a 5% "limit" and thus inevitably let the law be read as saying that 5% is acceptable, is to cause <u>more</u> investment in state and local securities than we have seen in over 20 years! Indeed, more than a doubling, even a tripling, of the holdings we have seen since 1973!

Since the pension plan boards and staff in so many states have fought so hard for so long to reduce or eliminate the obvious nonsense of tax-exempt securities in tax-exempt portfolios, surely the Federal Government should not undermine or reverse those efforts, especially not in the name of a statute to promote the soundness and prudence of the plans affected.

I suggest that the ceiling be 2.5%, with provision making clear that existing holdings are "grandfathered" and with legislative history making clear that special situations, like New York's (where the holdings of City and MAC securities went over 30% of fund assets) shall be treated as that situation was, by special exception with safeguards to protect the Federal interest in tax-favored pension funds. (Just as the NYC situation has been surrounded with safeguards, thanks to the work of this Committee, particularly Senator Lloyd Bentsen, see P.L.

95-339, NYC Loan Guarantee Act of 1978, and House Conf. Rpt. 95-1369.)

Second suggestion about S. 2105 and 2106: For all their excellence, the bills seem to leave out or bury such crucial data as rate of investment return, measurement of risk, and some others. I hope to have the privilege of working with your staff to assure that the bill includes the details necessary to carry out its invaluable intent.

Let me close by pointing to examples of how good state and local pension disclosure can be, and how bad. Just over a year ago, speaking to a consequential group of state pension officials, I gave out awards for good disclosure. Now, my awards could not compete with Oscars, Tonies, etc., unless they had a good name (and maybe not even then?). It was obvious at once that there was only one right name for these Awards to Public Pension Plans for Outstanding Disclosure--The Godiva. A few months ago, invited for the fourth time to address that same group, I awarded the Second Annual Godivas and in addition gave new "awards" for <u>bad</u> disclosure, the "Oscar the Grouch" Award (Oscar is the garbage-loving grouch of Sesame Street), as well as an award for disclosure that seems to be good but isn't, the Mickey Mouse.

Examples of good disclosure help us see what can be done:

1980 Godiva Awards
for excellence in public pension disclosure

1. Ohio State Teachers, the Queen Godiva:	-- For the best summary annual report to participants, both loaded with financial information and clear enough to be read
and a second Godiva:	-- For the only disclosure of how participants have fared vis-a-vis inflation --and over 50 years.
2. Alabama Retirement Systems, one-half a Godiva:	For exemplary detail on equity performance, although much less on bonds.
3. California State Teachers, two Godivas:	-- For full information on broker-dealers' fees and commissions
	-- For full information on proxy votes cast
4. New York Common Retirement Fund:	For opening a public information room with complete array of reports routinely available
5. Virginia Supplemental Retirement System:	For noting what their investment managers did and did not deserve credit for in the fund's performance.

<u>The 1981 Godiva Awards</u>

1. Minnesota State Board of Investment:

The 1981 <u>Queen Godiva</u>--	For unprecedented completeness and sophistication in disclosure of investment performance, <u>et al</u>.

2. Arizona, Arizona Public Safety, New Jersey, North Carolina, and Washington State:

Princess Godivas--	For particular details, e.g. on outside managers' performance, manager by manager; or on handling of cash equivalents; or on broker-dealer data.

3. Indiana State Teachers:

A Princess Godiva--	For explaining the particular importance of the ratio of accrued service costs to active member payroll, and showing this fund's 10-year trend of steadily declining financial strength.

4. Kentucky Retirement Systems:

A Princess Godiva--	For disclosing that its outside performance evaluator, comparing this fund to 99 other retirement funds over the 1975-79 period, found Kentucky second worst of the 100.

5. Ohio Public Employees:

A Princess Godiva--	For exemplary fullness and clarity of actuarial data.

6. California State Teachers:

A Princess Godiva-- For adding a cautionary note explaining the danger of misusing their chart comparing actual investment returns with their actuarially assumed returns.

First Annual Oscar the Grouch Awards
<u>for bad disclosure</u>

(no names revealed this year, but will be in the next annual round)

1. To the State Treasurer who disclosed only one year's equity performance, two years' bond "performance" using only the <u>cost</u> values--but reported fully on the 92,137 pages and 2,084,085 lines produced by the word processing center.

2. To the State Board which gave inconsistent performance figures on different pages; explained what each of its six main actuarial assumptions <u>mean</u> but then omitted to reveal what were the assumed figures; and reported that the report itself cost $27.50 per copy to produce, for a total of $19,250 publication cost.

3. To the State Department of Insurance (for its report of examination on public employee pension funds) which reported not only aggregate dollar amounts of equity holdings but also the aggregate amount of shares (e.g., 100,000 AT&T, plus 200,000 GM, plus 300,000 XYZ = 600,000 shares); which also said that the State's small funds invested wholly in fixed-income securities had done well because 1979-81 was a good period for such investments; and above all, which screamed about the worsening health of the State's public funds because their unfunded liabilities had continued to rise, but looked only at absolute dollar figures and ignored the fact that the ratio of assets to unfunded liabilities had improved from 40% to 52%.

4. To the State Treasurer who disclosed an endless array of balance sheet data, e.g. month-by-month cash balances, and the number of citizens' phone calls and visits to field offices for assistance, annually <u>and</u> month-by-month; but gave <u>no</u> investment performance data.

The First (not necessarily annual) Mickey Mouse Award
<u>for disclosure that looks good but isn't</u>

To the California State Controller
and Howard E. Winklevoss and Associates (consulting actuaries), for a special section in the Controller's Second Annual "Financial Transactions of Public Retirement Systems":

For a superb goal, a "comprehensive analysis of current and expected future financial condition of five public pension plans in the State," down to 1999. But then the analysis expressly declined to "predict the future costs or funded ratios of the plans studied," and only "observe[d] the financial consequences of each plan's current funding policy."

That is, they evaluated whether the actuarial <u>policy</u> was sound, and ignored all realities of how that policy related to past practices or future prospects.

* * *

Prospects for state and local pension funds are not good: the budget crunch is bound to impact them. Pension contributions are particularly vulnerable to deferral, like capital outlays which already are being deferred to a frightening extent, having actually fallen in real terms by over 20% since 1976. We have been in a healthy period of strengthening public pension funds, but state and local budgets are heading into a time of terrible stringency. We have been cushioned from this so far: the 50

States ended Fiscal 1980 with a surplus of $11.3 billion, 9% of that year's spending, but in Fiscal 1981 the surplus went below the agreed-upon safety level, at $4.7 billion (3.3%); and Fiscal 1982's surplus is projected at $2.3 billion (1.5%) (NGA, Fiscal Survey of the States, 1980-81, Sept. 1981). Deficits, illegal in most states, are unavoidable--or we will suffer contortions to avoid deficits--in many states this year or next.

For the bills you are considering, the impact of this fiscal distress is plain: never have we so much needed effective disclosure about the health of state and local pension plans. The need for PERISA has become urgent.

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Senator CHAFEE. Thank you very much, Professor Schotland.

What about the constitutional argument raised by Governor Peabody?

Mr. SCHOTLAND. Well, I am from that generation at Harvard Law School which has a special regard for Governor Peabody. I with all respect have to state that the statement is, in the first place, wrong; in the second place, it is disturbingly incomplete, even on key relevant law. In the last, maybe most important place, it utterly ignores which committee this is. This is the committee——

Senator CHAFEE. Outside of that, you agree with it? [Laughter.]

Mr. SCHOTLAND. Precisely, Senator. This committee is not the Commerce Committee. The NLC decision was on very narrow grounds. It was on the commerce clause. It only had four Justices clearly supporting it, even at that.

Only last week, in a 9-0 decision on the Long Island Railroad, we saw that even as to commerce, the NLC decision is being kept extremely narrow. The decision expressly excepted the spending power. Therefore, I think the involvement of this committee is not only beneficial, but is asserting the key Federal interest here.

Further, the opposition on the National League of Cities grounds might have a point if—I do not agree it does, but it might—if this were like ERISA; that is, if this bill had funding requirements, if it had vesting requirements. But there is no way with mere reporting and disclosure.

A California district judge, ignored in Governor Peabody's statement, held in five paragraphs that there was no case to California's effort to resist filing 5500's, no case because of your statute, the Internal Revenue Code. California did not even appeal that.

New York City did not change its investments without an exemption from this committee. That is a statutory exemption that came through you and Ways and Means. Why did they do that? They did not doubt that they are hooked by their accepting the favorable tax treatment.

Senator CHAFEE. Governor Peabody, would you care to respond?

Governor PEABODY. Well, first of all, I have great respect for Professor Schotland, even when he comments on my humble legal submission to this committee. But I further endorse, however, a statement that he had made earlier, in 1978, and which I expressed again to you, Mr. Chairman, the fact that you should request some constitutional lawyers. He suggested Dean Griswold or former Attorney General Levy. I would add former Attorney General Bell. I am sure you can get some former State attorneys general to submit some opinions to these panels on the constitutionality of this issue.

IONS TO THESE PANELS ON THE CONSTITUTIONALITY OF THIS ISSUE.

Now, much has been said by you and also by Professor Schotland that effective disclosure is the least intrusive way of going about this. But little is said about the fiduciary responsibilities that are put into your statute.

Little is said about the opening given in section 303 of S. 2106 to the Secretary of Labor to prescribe such regulations as the Secretary finds necessary or appropriate to carry out the provisions of the act.

Little is said of creating an entirely new agency, the Employee Benefits Administration. Little is said of the burdens that may be placed on the States to comply with the requirements of the reports. The bill comes up with 22 pages of legislation setting forth what must be included in the plan. However little he or this committee suggests it may be, it is more than a lot to me.

While it is not four-square perhaps with the *National League of Cities* v. *Usery*, it is pretty close to it. Everyone knows that the way you start moving in a direction in this area is to put the nose under the tent or nibble around the edges, and the next year you move on. That is the history of legislation.

In my opinion, there are very grave constitutional questions which Professor Schotland himself has earlier raised and which I think have not been answered.

Senator CHAFEE. Senator Matsunaga.

Senator MATSUNAGA. Thank you, Mr. Chairman.

First of all, I want to congratulate all three of you for your statements, and especially Professor Schotland for having the benefit of going to Hawaii. Now at least you will have the satisfaction of knowing what heaven looks like if you happen to be directed to go the other way. [Laughter.]

Governor, I believe I will discuss the matter with the chairman and take your suggestion and get some legal opinions from constitutional law experts on this. I am sure the chairman would welcome your suggestion.

But what bothers me about your statement is that I can see no real burden on the part of the State in meeting the reporting requirements of S. 2106.

If the information sought by PERISA disclosure is something desirable, regardless of Federal legislation, then it is something which the State and county governments themselves would be providing anyhow if they are operating their retirement system as they ought to.

Governor PEABODY. In my opinion, Senator, they should be providing it and there should be model laws or State laws providing in every State that they should provide it. And I do not underestimate the need for so doing. I merely state that that is not all of this bill, of the PERISA bill. That is just a part of it.

Another part of it is to determine what you can invest in or what you cannot invest in in terms of securities in your own State.

Senator MATSUNAGA. But you raised no constitutional objection relative to disclosure.

Governor PEABODY. I raise a question because that is the nose under the tent and that is only part of the nose that is in this legislation.

Senator MATSUNAGA. Well, of course, what we are primarily concerned with, as you well know in your own experience as Governor, is the protection of the beneficiaries intended by pension acts.

Governor PEABODY. Well, everyone should be concerned about that. But I just raise the question as to whether this is the way to go about it.

Senator MATSUNAGA. If, as has been suggested, there are certain State and municipalities, States and municipalities which are not doing what appears to be in the best interest due to local politics, if they are unable to do it, sometimes Big Brother needs to step in. This may be a situation of what Big Brother needs to do.

Governor PEABODY. I would agree this has not received the attention in the States that it deserves, but here today I listened all morning to labor union leaders from all over the country and other groups representing teachers and teachers retirement associations here.

You and I know, having been in politics, that these are very powerful groups. They are powerful in their home States and in their home municipalities. That is the area where the spotlight should be focused and focused hard.

I heard, and I was impressed too, by the representative from the State of Michigan, who obviously has been very conscientious and indeed frustrated in his efforts to bring proper attention to bear in his particular State. I compliment him for his efforts.

But I just believe that we are foreclosed from solving it in this direction. And I think that there are other directions that we should go in, some of which I have suggested.

Senator MATSUNAGA. Thank you very much.

Senator CHAFEE. Thank you, Senator.

Yes, Professor, did you have a statement?

Mr. SCHOTLAND. Senator, if I could just bring out one or two last points, if you have a moment.

Senator CHAFEE. All in a minute.

Mr. SCHOTLAND. In February 1981 the National Governors Association's Subcommittee on Public Retirement Systems, chaired by Governor Ariyoshi, listed improved financial disclosure as the top priority in State and local pension reform.

With that recommendation from the Governors, with the conclusion noted earlier from the MFOA study, the showing by Rand, how seriously can we take any of these objections to PERISA disclosure requirements? It is not four-square with League of Cities. The California District judge said "it is a far cry from the National League of Cities."

In 1937, two events: the Internal Revenue Code said exclusive benefit of retirement, and if they want to pick up the Federal tax treatment, they have got to protect the Federal fiscal interest.

The other event is, we started running a previously private pension system, a huge one, for railroad workers. Now, we had to pick that up because otherwise those railroad workers would not have had pensions. I submit, as cities and States are unable to come through with the pension promises they have made, this committee will be told we have to pick that up, too. The only way to make sure that call does not come soon or, hopefully, does not come at all, is to get the information out so that local political processes will take care of themselves. That is what the New Federalism surely is about.

Senator MATSUNAGA. Are you saying the nose has been in the tent already?

Mr. SCHOTLAND. Since 1937.

Senator MATSUNAGA. Smell something foul?

Mr. SCHOTLAND. Well, I did not want to go that far.

Mr. KLAUSNER. Mr. Chairman, may I?

Senator CHAFEE. Yes, Mr. Klausner.

Mr. KLAUSNER. A final comment. Cities and counties do not get cold, they do not have to eat, they do not go to the doctor. I am talking about real people who need that retirement check in the mail every month.

Consider the burden of filling out a few extra forms now compared to the burden of a nation full of retirees who have worked hard and contributed their money, and they are told the check is not there. That is the issue before this committee.

Senator CHAFEE. Well, I thank each of the members of the panel and those previous.

The hearing is adjourned.

[Whereupon, at 12:10 p.m., the subcommittee was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

STATEMENT OF THE

AMERICAN ACADEMY OF ACTUARIES

ON S 2105 and S 2106 ("PERISA")

TO THE SENATE SUBCOMMITTEE ON

SAVINGS, PENSIONS, AND INVESTMENT POLICY

APRIL 8, 1982

I. Introduction

The American Academy of Actuaries ("Academy") is pleased to submit these comments on S 2105 and 2106, each entitled the Public Employee Retirement Income Security Act of 1981 ("PERISA"). The Academy is vitally interested in these bills, since the large majority of actuaries performing actuarial services for state and local public employee retirement systems are members of the Academy. Appendix A contains some background information about the Academy.

These bills are very comprehensive, having a number of provisions that would affect the work of actuaries in connection with state and local public employee retirement systems. However, we would prefer to make specific comments today on only three aspects of the bills: the relationship between actuaries and accountants, the enrollment of actuaries, and the question of pension terminology.

Before making those comments, we would like to address some of the technical material in these bills. A committee of the Academy spent many hours reviewing the reporting and disclosure provisions of these bills (with particular emphasis on those sections which deal with actuarial disclosure), and although the Academy takes no stand on these sections with respect to their desirability, we are satisfied with their content from a technical standpoint.

II. Relationship Between Actuaries and Accountants

The relationship between actuaries and accountants under the Employee Retirement Income Security Act of 1974 ("ERISA") is important background to consider, since the general framework of PERISA is similar to that contained in ERISA in this area. However, despite their similarity, PERISA contains some fundamental differences from ERISA which will be discussed in Section III of this statement.

ERISA has given rise to an unresolved problem in the auditing area. Section 103 of ERISA provides that the accountant may rely on the correctness of any actuarial matter certified to by an enrolled actuary, if he so states his reliance (and conversely, that actuaries may rely on the work product of qualified accountants in an analogous manner). However, this provision has never become operational in the manner which Congress intended. This results from audit guidelines (which predate ERISA) issued by the American Institute of Certified Public Accountants (AICPA) which state that any opinion of an auditor which expresses reliance on the work of others becomes a "qualified opinion," with all the resulting negative connotations attached to that term. The AICPA has not changed this position, despite the statutory authority for such an expression of reliance contained in ERISA.

III. Analysis of S 2105 and S 2106

Sections 1104-1109 of S 2105 and Sections 104-109 of S 2106 are quite similar to Section 103 of ERISA in dealing with the relationship between actuaries and accountants, with two notable exceptions:

1. Section 1106(a)(2) of S 2105 and Section 106(a)(2) of S2106 provide that the accountant shall rely on the correctness

of any actuarial matter certified to by an enrolled actuary. Likewise, Section 1107(b) of S 2105 and Section 107(b) of S 2106 provide for similar reliance by actuaries on accountants. Thus, PERISA changes the voluntary reliance of ERISA to compulsory reliance.

2. Section 103(a)(3)(A) of ERISA indicates that audits shall be conducted in accordance with "generally accepted auditing standards." Section 1106(a)(1) of S 2105 and Section 106(a)(1) of S 2106 contain the same wording, with the important addition that the reliance provisions described above are specifically authorized, even though departing from generally accepted auditing standards as presently defined by the AICPA.

The Academy strongly endorses these two provisions contained in PERISA. We believe that they would be quite beneficial in resolving the difficulties which have arisen under ERISA, as described in Section II of this statement. Furthermore, we believe that they are quite compatible with the division of responsibilities between actuaries and accountants intended by the Congress in the implementation of Section 103 of ERISA.

In addition, the Academy would like to prepare several additional amendments to further clarify the relative roles of the two professions. These amendments are consistent with the intent of S 2105 and S 2106 and are submitted for the consideration of the Subcommittee in Appendix B.

IV. Other Legislation

We would also like to call attention to the fact that major ERISA revision bills currently before the Congress contain provisions similar to those contained in PERISA described above. In particular, HR 4330 and S 1541 (the Retirement Income Incentives and Administrative Simplification Act of 1981) contain such provisions.

We believe that these bills, along with S 2105 and S 2106, are indicative of strong congressional interest in resolving the relative roles of actuaries and accountants on a consistent basis in all areas of pension legislation. We strongly support these efforts.

V. Enrollment of Actuaries

When ERISA was passed in 1974, it contained a provision for enrollment which allowed for a "grandfathering" of actuaries in practice at that time who met the qualifications and applied for enrollment prior to January 1, 1976. Those who did not so qualify or who did not apply by that date were subject to more extensive education or examination requirements and experience requirements after that date.

Actuaries practicing in the private field were, of course, quick to apply so as to be qualified for continued practice in their profession. On the other hand, actuaries dealing with public employee retirement systems did not have the same need for enrollment and, in some instances, did not therefore apply for enrollment.

If PERISA should become law, those actuaries who practice exclusively in the public sector but who have not become enrolled actuaries would not have had the same advantages afforded to them as was the case for the private pension actuaries in the initial enactment of ERISA. To correct this inequity, Section 1002(18) of S 2105 and Section 3(17) of S 2106 would allow to actuaries exclusively in the public sector the same privileges for initial qualification as were allowed under ERISA to actuaries for private plans. The Academy supports these provisions.

VI. Pension Terminology

Over the years a variety of pension terminology has evolved in laws and regulations and in the pension literature. We note that PERISA contains a number of terms for certain actuarial values which differ from those contained in ERISA.

The actuarial profession recently received a report from the Joint Committee on Pension Terminology composed of respresentatives from various actuarial organizations. This committee's charge was to arrive at a more uniform, consistent and unambiguous set of terminology. This report has now been formally endorsed by the governing boards of all U.S. actuarial organizations dealing with pension matters. The report is submitted for the consideration of the Subcommittee as Appendix C.

At the present time, the language of S 2105 and S 2106 is being reviewed for consistency with the terminology committee's report. In the near future, we will submit to the Subcommittee a list of those terms in the bills which would need to be changed in order to bring the bills into conformity with the terminology report. We will also be proposing that similar changes be made in ERISA as well.

VII. Summary

In summary, the Academy strongly supports the provisions of S 2105 and S 2106 concerning the relationship between actuaries and accountants. We would also like to recommend additional amendments which are consistent with the intent of the bills to further clarify this relationship. We also support provisions of the bill authorizing special initial enrollment procedures for actuaries operating exclusively in the area of public pension plans. Finally, we would recommend that certain terminology be amended in light of the effort within the actuarial profession to foster the adoption of uniform terminology.

Douglas C. Borton, Chairman
Pension Committee

Subcommittee on Public Employee
Retirement Systems
Thomas P. Bleakney, Chairman
James A. Beirne
Barry M. Black
Edward H. Friend
James B. Gardiner
Norman S. Losk
Robert H. Smith

APPENDIX A

BACKGROUND INFORMATION ON THE AMERICAN ACADEMY OF ACTUARIES

The American Academy of Actuaries is a professional association of actuaries which was formed in 1965 to bring together into one organization all qualified actuaries in the United States and to seek accreditation and greater public recognition for the profession. The Academy includes members of three founding organizations - the Casualty Actuarial Society, the Conference of Actuaries in Public Practice, and the Society of Actuaries.

The Academy serves the entire profession. Its main focus is the social, economic, and public policy environment in which the actuarial profession functions. Its primary activities include liaison with federal and state governments, relations with other professions, public information about the actuarial profession and issues that affect it, and the development of standards of professional conduct and practice.

Over 6,600 actuaries in all areas of specialization belong to the Academy. These members are employed by insurance companies, consulting actuarial firms, government, academic institutions, and a growing number of industries. Actuarial science involves the evaluation of the probabilities and financial impact that uncertain future events - birth, marriage, sickness, accident, retirement, and death - have on insurance and other benefit plans.

Membership requirements can be summarized under two broad headings: education and experience. At present, the educational requirements can be satisfied either by passing certain professional examinations sponsored by the Casualty Actuarial Society or the Society of Actuaries, or by becoming an enrolled actuary under the Employee Retirement Income Security Act of 1974 (ERISA). The experience requirement consists of three years of responsible actuarial work.

APPENDIX B

PROPOSED AMENDMENTS TO S 2105 AND S 2106 BY THE AMERICAN ACADEMY OF ACTUARIES

Note: All page numbers refer to the respective bill.

S 2105

1. page 33, line 10	add two new sentences after "actuary" as follows: "The opinion of the accountant under this section shall not extend to actuarial matters certified to by the enrolled actuary. 'Actuarial matters' may be further defined by regulation by the Board and shall include the items required to be included in the actuarial statement under Section 1107."
2. page 34, line 21	delete "liabilities" and substitute in its place "non-actuarial liabilities of the plan."
3. page 36, line 10	insert before "liabilities" the word "non-actuarial."

S 2106

1. page 31, line 22	add two new sentences after "actuary" as follows: "The opinion of the accountant under this section shall not extend to actuarial matters certified to by the enrolled actuary. 'Actuarial matters' may be further defined by regulation by the Secretary and shall include the items required to be included in the actuarial statement under Section 107."
2. page 33, line 8	delete "liabilities" and substitute in its place "non-actuarial liabilities of the plan."
3. page 34, line 22	insert before "liabilities" the word "non-actuarial."

APPENDIX C

[Report of the Joint Committee on Pension Terminology]

STATEMENT

OF THE

AMERICAN BANKERS ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

SENATE COMMITTEE ON FINANCE

ON THE

PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT

(S. 2105 and S. 2106)

March 30, 1982

The American Bankers Association is a national trade association whose members consist of more than 13,000 banks, more than 90 percent of the full service banks in the United States. More than 4,000 of these institutions are authorized to serve as fiduciary and many of these presently serve employee benefit plans in one capacity or another.

It is our intent, as professional fiduciaries who must comply with the requirements of ERISA, to share some of our experiences with the Subcommittee. We offer our comments so that the Subcommittee, if it concludes that regulation of public employee plans is necessary, will avoid imposing upon them those requirements contained in ERISA that are unnecessary and burdensome.

ABA supports the intent of ERISA's fiduciary provisions and we are pleased to see that intent carried forward to S. 2105 and S. 2106, the PERISA bills under consideration. We are especially pleased that the prohibited transaction provisions of this legislation are substantially revised from those contained in ERISA. After nearly eight frustrating years of laboring under the prohibited transactions provisions in ERISA we have concluded that they are overly burdensome to trustees without providing any commensurate benefit to plan participants. We are pleased to see our concerns addressed in this legislation.

Prohibited Transactions

ERISA Section 406 enumerates a broad list of transactions into which a fiduciary of a plan may not enter. Subsection (b) prohibits transactions which are essentially self-dealing in nature. Subsection (a) on the other hand lists the activities into which a fiduciary may not cause a plan to enter with a "party in interest". A "party in interest" is defined to include an almost limitless class: an employer, or 50 percent owner of an employer, whose employees are covered by the plan, any counsel or fiduciary of the plan, or a relative of any of these. The term also includes employee organizations whose members are covered by the plan and any employee, officer, director, 10 percent shareholder or partner or joint venturer of an employer, service provider or employee organization.

The types of transactions prohibited include sales or exchanges of property, lending of money, furnishing goods or services and the transfer to or use by a party-in-interest of any of the plan's assets.

When one considers that many large plans have several banks, investment advisors and insurance companies, all managing portions of the investments, not to mention all the other entities which may provide services to the plan, total avoidance of prohibited transactions becomes virtually impossible in the ordinary course of business. For example, one investment manager could properly wish to invest in certificates of deposit of a bank which is trustee of another portion of the plan. Such purchase, without exemption, would be a violation.

The number and variety of possible transactions that are prohibited are enormous and the vast majority would be innocently entered into in the plan participants' best interests. It is unreasonably burdensome for even the most diligent trustee to keep track of the ever changing list of parties in interest and to review all these relationships with respect to each and every plan transaction. This is particularly true where large plans are involved. Implementation of the needed procedures is expensive and time consuming, and serves no productive purpose other than avoidance of a violation of these provisions.

We were told at the time the prohibited transaction provisions were formulated that the exemption procedure would be applied by the Department of Labor in a manner so as to alleviate any unproductive and unreasonable burdens resulting from these provisions. The ABA, however, has found the exemption procedure in ERISA to be ineffective. We can say this from direct experience for 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 a little over 3 1/2 years, while our third, filed in May 1977, took a little less time. Our fourth application, filed in March 1979, was processed in a little less than two years, but was incomplete in that the Labor

Department has not yet cleared banks to be compensated for the securities lending service involved. Furthermore, the needlessly detailed restrictive conditions and limitations placed by the Department of Labor on class exemptions when they finally are granted limit their value.

As burdensome as these provisions are to fiduciaries, it is even more important to recognize that the prior restraint imposed by ERISA's prohibited transactions has resulted in numerous lost investment opportunities and cost potential income to plans. We wish we could quantify the lost opportunities, but that is simply not possible. For example, who can say how many plans were deprived of the additional income from the lending of securities during the nearly 2 year pendency of that class exemption? During most of that time one plan's participants were earning income from the lending of its securities because it had received an individual exemption. Even today plans are missing out on additional income from securities lending because some trustees are uncertain they can be compensated for this additional highly specialized and costly service without violating ERISA.

Problems the prohibited transactions have created for plans are many. For example the purchase by a bank trustee of high quality securities is a prohibited transaction problem merely because the issuer happens to be a bank or insurance company which is managing another portion of the trust. This problem arises quite often, as does the situation in which a bank is named successor trustee and, in assuming control of the assets, finds its own securities among the portfolio investments.

Private placements, mortgages and mortgage related investments have become a nightmare of complexity because of the prohibitions and the number and variety of service providers who may be involved. One bank, serving as custodian for the trustee of a plan, was directed to purchase a long term mortgage on real estate. Upon investigation it became clear that the mortgage would have been an excellent investment but the bank, on the commercial side and totally independent of the trust department, also happened to be the construction lender on the project. As a result the mortgage purchase was prohibited.

We are somewhat encouraged by the fact that the Labor Department has made special efforts and is becoming more efficient in issuing exemptions. Nevertheless, any system of prior approval will result in missed opportunities for plans because of the time delay inherent in the most efficient process. It is impossible to even attempt to estimate the number of exemption applications which were never filed because of the administrative burden and legal expense involved. The real cost is borne by the plan participants and their beneficiaries who lose the advantages of the added income and who must bear the considerable expense entailed.

ABA strongly supports efforts to avoid repetition of these problems in PERISA. S. 2106 would establish standards relating to adequate consideration, adequate security and reasonable rates of interest in lieu of ERISA's "prior restraint" rule. Thus it would preserve the protections intended by the prohibitions. This approach represents a major step forward. We should point out, however, that Section 206(a) of S. 2106 might have the unintended effect of creating a duplicate set of fiduciary standards that could exacerbate confusion for plan fiduciaries. The fundamental standards of adequate consideration, undivided loyalty, exclusive purpose and prudence are contained in Section 204 of that bill and are applicable to all plan transactions, not just those with parties in interest. The reintroduction of these standards in the specific context of party in interest transactions raises the implication that these duties may be somehow different in these situations. In addition, plan fiduciaries would still be required to engage in the tremendously burdensome and difficult process of identifying parties in interest.

Therefore, ABA much prefers the approach contained in S. 2105. That bill would delete entirely the prohibition on party in interest transactions. In so doing it does not dilute the protections afforded plan participants. Rather, S. 2105 recognizes that the fiduciary standards contained in the bill already provide these protections without imposing the unnecessary disruptions, confusion, or burdensome compliance requirements of the current prior restraint rules. In essence, the protections afforded by the fiduciary standards make prohibitions on party in interest transactions redundant.

If one were to objectively review its enforcement efforts it would appear that the Department of Labor supports our view, for DOL has seldom relied exclusively on Section 406(a) in fiduciary actions. Further, the Secretary of Labor has testified that the Department on its own initiative is developing a broad exemption from the prohibitions on party in interest transactions, at least for qualified professional asset managers.

In summary, it is ABA's firm conviction that prohibitions on party in interest transactions are unnecessary not merely because the burdens they impose are excessive in relation to the protection offered plan participants but further because they provide no substantive protection that participants do not already enjoy.

It is apparent from this report that banks have experienced a great deal of difficulty under ERISA's rules. ABA would urge the Subcommittee at its earliest opportunity to consider S. 1541 which is presently under study in the Labor Subcommittee. It addresses many of ERISA's problem areas and would go a long way toward establishing a framework permitting more efficient administration of those plans.

Collective Investment

Banks offer a wide diversity of collective investment funds for their employee benefit customers and their personal trusts as well. These collective funds offer greater efficiency of management and the benefits of lower transaction cost and investment diversification. They also offer a broader range of investment. Because of these attractions a number of public employee plans have expressed a desire to be invested in bank collective funds. Unfortunately most public employeee plans may not participate because the bank funds are restricted to qualified employee benefit plans and most public employee plans are not qualified. As a result many diversification opportunities are missed by these plans. This result occurs even where specific state authorization for investment in collective funds exists and, further, would not be changed by the fact that both bills under consideration today envision the investment of these plans in bank collective investment funds. The tax provision of S. 2105 which would treat these plans as qualified is needed to solve this problem.

A broader solution would be to authorize banks to sponsor and sell mutual funds. Such authority is now under consideration in the Banking Committee. In contrast to the bewildering restrictions which presently govern which accounts may be invested in which collective funds, mutual fund authority will permit banks to offer the benefits of a single registered fund or group of funds to their IRA, Keogh, corporate and public employee benefit plan customers as well as to the general public.

Fiduciary Status and Co-Fiduciary Duties

Our Association is concerned about the definition of "fiduciary" contained in Section 3(18) of S. 2106. The term is defined so broadly that "fiduciary" 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. Section 1002(19)(C) of S. 2105 recognizes this fact but it continues to hold directors officers or employees of a corporation liable unless a corporation assumes liability and, in the event of a money judgment against it, the corporation is able to pay. We believe this provision could deter many capable individuals from working for corporations which serve as fiduciary to these plans. Also we suggest this "piercing of the corporate veil" presents questions of public policy which should be studied carefully.

We urge instead the following language be included in the definition of fiduciary: "(C) If a corporation or an employee organization is a fiduciary with respect to a plan, a director, officer or employee of such corporation or employee organization when acting in such capacity, shall not be a fiduciary with respect to such plan."

ABA has long been troubled by the scope and application of the co-fiduciary responsibility rules contained in ERISA. Our concern lies in the ambiguous language of ERISA Section 405(b) which is similar to the language contained in Section 1205(b) of S. 2105. As proposed "each such trustee shall use reasonable care to prevent any other such trustee from committing a breach." Co-trustees have traditionally existed only where an instrument creating the trust grants more than one person authority to act in concert over the same trust assets; A separate and distinct situation exists where each of several trustees is given responsibility over a different portion of the trust's assets. A master trust arrangement, for example, may involve a master trustee with no investment duties and several other trustees each with investment duties for different portions of the plan (e.g., equity securities, fixed income securities, real property and international investment). To require each of these trustees to monitor each other's actions is inconsistent with the underlying policy which is to permit allocation of duties and limitation of liability to duties assumed. The language of Section 205(b)(4) of S. 2106 appears to delineate more clearly the responsibilities of the respective parties.

<u>Employee Benefit Administration</u>

Title II of S. 2105 would establish the Employee Benefit Administration as an independent agency within the Executive Branch. That agency would be charged with administering ERISA as well as PERISA, if the latter is enacted. ABA supports the establishment of a single agency. We believe that consolidation of the functions now scattered among different government departments will encourage increased retirement savings and foster the growth of the private pension system.

The frustrations experienced by bank fiduciaries with both IRS and the Department of Labor since the enactment of ERISA are far too numerous to detail in this statement. The Labor Department for too long has failed to exhibit a sensitivity to reporting burdens. Further, the exemption proceedings continue to take far too long and the product contains too many limitations and restrictions.

A single agency, we believe, will provide efficient administration of the law, reduce costs to government, and within the government provide unified policymaking to support the continued development of the private pension system.

ABA hopes our thoughts and experiences with ERISA are helpful to the subcommittee as it considers PERISA legislation.

TESTIMONY OF
IRA M. LECHNER
ON BEHALF OF
THE NATIONAL ASSOCIATION OF POLICE ORGANIZATIONS, INC. (NAPO)
S. 2105 and S. 2106
(PERISA)
UNITED STATES SENATE
COMMITTEE ON FINANCE

The National Association of Police Organizations, Inc. (NAPO) represents over 100,000 police and safety officers throughout the United States. Its member organizations are located principally in California, New York, Michigan, Ohio, Texas, Massachusetts and the District of Columbia. NAPO is directly concerned with law enforcement and the men and women who constitute the "thin blue line" protecting the health and safety of your constituents.

Mr. Chairman, we appreciate the opportunity to present our views on such an important issue as public employee retirement funds. The men and women who put their lives on the line in law enforcement would like to retire someday after completing their service, and they would like to have healthy, well cared for pension funds to rely on as the source of their retirement income.

But, in all sincerity, we do not believe that the Congress should legislate in this area or that the Federal Government should become embroiled in the enforcement of the pension rights of county, city and state employees.

Mr. Chairman, we believe in the ability of the state and local governments to deal directly with the incipient problems concerning public employee pension funds which undoubtedly abound in many localities, though such has not been our experience in the states where our membership is principally located. Many believe that Section 102 of S. 2106 and Section 1102 of S. 2105 provide an exemption for any public employee plan from the coverage of this legislation to the extent that the law of a state or of a political subdivision of a state "applied a requirement to such plan substantially equivalent" to the proposed Federal law. However, the fact is that the exemption, even if granted, would apply only to Title I and Sections 212, 301(b) and 306 of S. 2106 and to the requirements of Subtitle A and Sections 1212, 1301(b), and 1306 of S. 2105. Thus, such exemptions would only insulate "substantially equivalent" state law plans from the reporting and disclosure provisions of the legislation, leaving them covered in any event by an entire range of provisions dealing with Fiduciary Responsibility and Administration and Enforcement. And, even such a limited exemption is left to the subjective judgment of the Secretary or the Board, as the case may be. That would be a very fragile reed upon which to build any confidence that unnecessary federal regulation will not occur.

Mr. Chairman, this leaves even "substantially equivalent" state law plans covered by Federal legislation, and regulation, with respect to: special asset rules, establishment of the plan, establishment of the trust, fiduciary duties, the extent of co-fiduciary duties, prohibited transactions, ten per centum limitation with respect to acquisition of employer securities, other employer obligations and employer real property, exemption from prohibited transactions, liability for breach of fiduciary duties, exculpatory provisions and insurance, prohibition against certain persons holding certain positions, and almost the entire sweep of Federal enforcement and administration.

We respectfully submit that in the first instance the states and their political subdivisions should be left to regulate public pension plans without any Federal intervention. In the alternative, the exemption of plans covered by "substantially equivalent" state laws should be broadened to exempt such plans totally from any and all aspects of this legislation. And, the determination with respect to the exemption specifically should be subject to review in the federal courts. We do not understand, Mr. Chairman, why Congress would desire to regulate some, or any, of the functions of plans which are covered by "substantially equivalent" state laws. We thought such duplication, and over-regulation, was no longer to be the norm in Washington. The involvement of the Federal government can only result in added expenses for public plans to operate, forcing them to deliver less to the ultimate recipient of all of this legislative exercise: the public employee. In the extreme, the plans may turn increasingly to social security as the employees' main source of retirement income. And that course of action, Mr. Chairman, we all know is frought with peril.

NAPO respectfully suggests that the Committee should investigate the number of terminations of old plans, as compared with the number of formations of new plans, since the establishment of ERISA. The figures are overwhelmingly in favor of terminations. Studies indicate that ERISA was the cause of a surprising number of terminations. We say "surprising number of terminations" because Congress was assured repeatedly before the passage of ERISA that all employees would benefit from the passage of the bill. The result, however, was that far fewer employees benefitted than was expected and many hundreds of thousands of employees lost all hope of a private pension plan when their employers terminated their plans rather than subject themselves to what many believe is excessive Federal regulation.

We hope and trust, Mr. Chairman, that with respect to public employee plans this will not be the result of this Congress' consideration of S. 2105 and S. 2106.

NAPO wishes to thank you again for this opportunity to present the views of the working cops of this nation.

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Mortgage Bankers Association of America

James F. Aylward, CMB
President
Mortgage Bankers Association of America
202-861-6501

April 23, 1982

The Honorable John H. Chaffee
Chairman
Subcommittee on Savings, Pensions, and
Investment Policy
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The Mortgage Bankers Association of America* (MBA) would like to take the opportunity presented by your Subcommittee's review of S 2105 and S 2106, to provide for pension reform for State and local public employee retirement systems, and for other purposes, to comment upon the desirability of pension fund investment in mortgages and the restrictions that the proposed legislation would impose on such investment by pension funds for public employees. The focus of MBA's concern is the "prohibited transactions" provisions of the legislation.

Both bills are patterned on the Employees Retirement Income Securities Act (ERISA) which has had the unfortunate effect of inhibiting private pension fund investment in mortgages, as is more fully explained later in these comments. S 2106 reflects a growing awareness that ERISA, as interpreted by the Department of Labor (DOL), has prevented private pension plan trustees and managers from making investments in home mortgages and other real estate financing securities that can provide both attractive returns and the diversity of type of investment that prudent investing requires. S 2106 reflects this awareness by incorporating in Title II the prohibited transactions provisions found in S 1541, recently the subject of hearings by the Subcommittee on Labor of the Senate Committee on Labor and Human Resources.

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- Mortgage Banking Companies
- Mortgage Insurance companies
- Life Insurance companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Pension Funds
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

Section 3505 of S 1541 and Section 206 of S 2106 would rewrite the prohibited transactions section of ERISA so as to prohibit only those transactions where the plan would receive less than adequate consideration, either in the form of money or property. This would appear to free all transactions that are consistent with other similar transactions in an active nationwide, or even regional, market, because the adequacy of the consideration could be measured by the market. Such a market-oriented test is a vast improvement over the current flat prohibition where there is an established market. However, as defined in Section 3(5) of S 2106, this test is not certain when applied to the mortgage market. To allow the natural course of pension investment in mortgages to develop fully, the test should be clear and certain. "Adequate consideration" needs a definition on which pension fund managers can rely without the threat that the Department of Labor will subsequently decide that a particular investment did not meet an undefined standard. Either by statutory provision or other legislative history, Congress should express its intent that "adequate consideration" does not mean the highest or lowest price obtainable, but rather means one which is not unreasonable under the circumstances.

Section 3511 of S 1541 and Section 208(b)(5) of S 2106 would clarify that assets in a pooled separate account of an insurer or assets in a collective investment fund of a bank or similar institution supervised by the United States or a state, are not "plan assets" for purposes of applying the prohibited transaction rules. The concept is a good one and it should be applied to mortgage finance as well. As is explained more fully later in this statement, one aspect of the mortgage banking function is to pool mortgages and issue securities backed by the pool of mortgages. Section 208 of S 2106 should be amended to exclude from the assets of a pension plan mortgages in a mortgage pool of a financial institution or business organization regularly in the business of issuing mortgage-backed securities. Pooled mortgages share the same characteristics as other assets in pooled separate accounts, and the relief of Section 3511 from the burden of tracing beneficial interests should extend to them as well.

The treatment of prohibited transactions in S 2105 appears to depart even more from ERISA than does S 2106, because the prohibited transactions section, Section 1206, applies only to fiduciaries. While this approach could be developed, perhaps, to avoid the ERISA impediments to mortgage investment, several problems remain with S 2106.

When the definition of fiduciary found in Section 1002(19) (A)(ii) is applied to the activity of the mortgage market, as more fully described later in these comments, the servicing of mortgages sold directly to a pension plan or the management of a pool of mortgages backing an issue of mortgage backed securities could qualify an individual or a corporation as a fiduciary subject to Section 1206. Even the exclusion of the pooled mortgages from the definition of plan assets would not solve this problem. Furthermore, the administrative exemption procedure provided in S 2105 appears even more cumbersome and less able to respond to mortgage market developments than the Department of Labor under ERISA or S 2106, because the Board of Directors of the Employee Benefit Administration, which would be established by S 2105, is required to afford an opportunity for a hearing in all cases, no matter how limited the request for exemption.

Fundamental changes that are occurring in the way housing is financed in this country should present new investment opportunities for pension funds. A combination of factors has severely reduced the effectiveness of the old mortgage finance system which relied heavily on mortgage investment by savings and loans and other thrift institutions. While in the future, thrifts may specialize in consumer and/or real estate lending, they will not hold long-term loans, such as mortgages, in portfolio to the extent they have in the past. This will create a home financing gap. Mortgages must be packaged and sold to pension funds and others with sources of long-term funds in order to fill the gap.

The demand for housing that is expected to occur in the 1980s will require a tremendous amount of capital. At the end of 1980, outstanding mortgage debt in the United States stood at $1.1 trillion. By 1990, that amount is expected to triple. Raising this volume of funds will require that mortgages be attractive to those who make long-term capital investments, such as pension trustees and managers.

Pension funds control an increasing share of American capital and so, must be tapped if sufficient funds are to be made available to housing. In addition, because they consist of stable long-term funds with an obligation to pay an annuity in the future, pension funds are ideally suited to mortgage investment. Public pension funds, i.e., those serving state and local government employees, are becoming increasingly important investors in residential mortgages. The Federal Reserve Board reports that such funds made net mortgage investments of $190 million in 1976, $679 million in 1978, and $1.3 billion in 1980. Private pension fund investment is so small as to be virtually non-existent, and MBA believes that this is because ERISA, which covers private, but not public, pension funds, creates a number of unnecessary barriers to mortgage investment.

MBA recommends neither S 2105, S 2106 nor any other legislation paralleling ERISA for public employee pension funds be enacted unless steps are taken to eliminate the barriers imposed on mortgage investment through administrative and legislative changes so that it is possible and practical for funds to invest in mortgages.

ERISA PROVISIONS

ERISA was enacted in response to well-documented and well-publicized abuses of their powers by trustees and others in positions to direct the use of pension plan assets. In establishing a nationwide, explicit test of fiduciary duty, and clarifying who are fiduciaries subject to the test, ERISA has worked well to encourage widespread responsibility in the pension field. These standards, especially the "prudent man" rule, were an incorporation of a variety of related standards that had been developed and tried over the years in the common law of the several states.

ERISA also introduced a novel approach to protecting pension beneficiaries from self-dealing and favoritism by those in positions to direct the use of plan assets. The "prohibited transactions" section of ERISA, Section 406 (29 U.S.C. 1106), has little legislative history and no widely used and developed antecedents. This section provides:

"PROHIBITED TRANSACTIONS"

"Sec. 406. (a) Except as provided in section 408:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

(B) lending of money or other extension of credit between the plan and a party in interest;

(C) furnishing of goods, services, or facilities between the plan and a party in interest;

(D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 407(a).

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should know that holding such security or real property violates section 407(a)

(b) A fiduciary with respect to a plan shall not—

(1) deal with the assets of the plan in his own interest or for his own account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

(c) A transfer of real or personal property by a party in interest to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a party-in-interest placed on the property within the 10-year period ending on the date of the transfer.

The general fiduciary duty approach of the Act rests on the assumption that pension managers can and should perform their trust by exercising their sound judgment in the best interests of the pension plan. In contrast, the prohibited transaction approach rests on the assumption that pension managers cannot and should not perform their trust by exercising their sound judgment in the best interests of the pension fund. It specifically prevents that exercise in a broad range of circumstances. The transactions prohibited by Section 406 are categorical and are not permitted by the Act, even if they would otherwise be in the best interests of the pension fund, or are routinely performed by other asset managers.

It is this observation that is so frustrating for those involved in home finance. The mortgage market is well established and active. It is a market that allows an investor or a pension plan trustee to measure the prudence of an investment against the investment decisions of other experienced investors. Yet ERISA effectively interferes with pension fund involvement in both the financing of new construction and in the financing of the purchase of existing, or older housing.

MORTGAGE MARKETS

Financing for residential building projects generally occurs in two phases: short-term loans to the project developer to pay for the cost of construction; and long-term loans to the purchasers of the residential units, the proceeds of which are used to pay for those units. The developer pays off the short-term construction loan with the proceeds of the sales of the units.

Before a lender will make a construction loan, it must be satisfied that long-term financing for purchasers of the units will be available when the units are ready for sale. Generally, such a lender, if it does not intend to provide the long-term financing itself, will require a commitment from another lender obligating the second lender to make such long-term financing available. Once a satisfactory commitment has been obtained, the construction loan will be made.

Often a developer seeking a short-term construction loan will contract a company that specializes in obtaining commitments for long-term financing—a mortgage banker. The mortgage banker first makes a determination as to the feasibility of the proposed project. If that determination is favorable, the mortgage banker will agree to attempt to obtain a commitment for long-term financing. The mortgage banker usually looks to financial institutions or institutional investors.

The investor usually issues a written commitment to provide long-term financing or to buy mortgages from a mortgage banker and, after the units are completed, makes long-term loans to purchasers of the units, or buys the mortgages originated by the mortgage banker. Long-term investors include insurance companies, commercial and mutual savings banks, savings and loan associations, and the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC), the two federally chartered instrumentalities whose purpose is to support an orderly mortgage market and pension funds. A commitment is made for a specific time period, and a fee is usually charged by the investor.

Under a typical commitment, an investor obligates itself to provide a specific amount of long-term loans to purchasers of dwelling units who qualify under the investor's mortgage loan guidelines. In a case where the mortgage banker makes the commitment to provide long-term financing, the investor will obligate itself to purchase a specific amount of mortgages originated by the mortgage banker, provided that those mortgages meet the guidelines. The terms of the loans, such as the amortization period, the rate of interest, the percentage of value loaned, the requirements for loan qualification, the credit worthiness of the borrower, and the quality of the security, are set by the investor.

Usually, when an investor buys mortgages from the mortgage banker, the investor leaves with the mortgage banker the responsibility for collecting the monthly payments from the borrower, paying real estate taxes and hazard insurance premiums, and otherwise administering the loan. This function is performed for a fee and is called "servicing." Servicing fees are an important source of income for mortgage bankers.

The above explanation describes two markets for long-term mortgages. The "primary market" is the market in which the homebuyer obtains a mortgage loan, whether directly from an investor or from a mortgage banker.

The sale of the mortgage to an investor occurs in what is called the "secondary market." The secondary market also operates in a similar way to finance the purchase of existing, or older, housing. No construction loan is involved, of course, and the length of time a commitment to purchase the mortgages is outstanding is generally shorter. In fact, mortgage bankers sometimes agree to originate mortgages on existing housing without having a commitment from an investor, taking a chance that the mortgage can be sold after it is originated.

A variation on this basic way in which mortgage investors acquire mortgages as assets is the rapidly expanding market for securities issued by mortgage bankers and other loan originators based on a collection, or pool, of mortgages originated or otherwise obtained by the issuer. The most popular of these mortgage-backed securities are those whose scheduled payments of principal and interest are guaranteed by the Government National Mortgage Association (GNMA); a part of the Department of Housing and Urban Development (HUD). The mortgage-backed security device allows an investor to own a small portion of a large number of mortgages and thereby diversify risk and simplify accounting. Mortgage-backed securities are also generally more liquid than whole mortgages, that is, mortgages that are not part of a pool whose ownership is shared by several investors.

ERISA BARRIERS

If a pension fund wanted to be an investor in the mortgage markets as they now function, a violation of one or more of the prohibited transactions provisions of ERISA might arise due to a possible relationship between a pension fund and certain parties involved in the transactions. Fitting the definition of party in interest in Section (3) (14) of ERISA would be: a mortgage banker or other loan originator who is providing loan administration services on loans previously originated or purchased by the plan (a servicing mortgage banker); a developer of a project or a builder involved in the construction of the dwelling units who employs persons covered by a multiemployer plan; and an individual seeking a loan in order to purchase a dwelling unit may be party in interest under, among others, section (3) (14) (H) of the Act, by reason of being an employee of an employer, a service provider, or a union that is related to the plan.

Therefore, possible violations may arise in several phases of the above described transactions: The exchange of a loan commitment for a loan fee between a pension fund and a servicing mortgage banker may give rise to a violation of section 406(a) (1) (A) and (D) of the Act. A commitment by a pension fund to make loans or purchase mortgages, the proceeds of which will be used to purchase units developed and/or to be built, in whole or in part, by a contributing employer with respect to the fund, might arguably give rise to a violation of section 406 (a) (1) (B) and/or (D) of the Act. It should be noted, in this respect, that the Department of Labor has expressed its view that a transaction involving similar possible violations; i.e., the provision of a construction loan by a plan to an unrelated party who contracts with a contributing employer to do the construction, would not, in itself, constitute a prohibited transaction under section 406 (a) of the Act. If, in the case described in (ii) above, the employer is a fiduciary with respect to the fund, the mere involvement of the employer as a developer or builder might, in itself, be characterized as a technical violation of section 406 (b) (2) of the Act.

The purchase of a mortgage by a fund from a servicing mortgage banker, or a direct loan by a fund, the proceeds of which loan are used to purchase a dwelling unit, which purchase results in the repayment, in whole or in part, of a construction loan to a servicing mortgage banker, might give rise to a violation of section 406 (a) (1) (A) and (D) of the Act. If the proceeds of a direct loan or a loan purchased by a pension fund are used to purchase a unit developed and/or built, in whole or in part, by a contributing employer, such loan or purchase might be characterized as a violation of section 406 (a) (1) (D) of the Act. A direct or indirect (through the purchase of a mortgage) loan by a pension fund to a purchaser of a dwelling unit who is an employee of a contributing employer, service provider, or related union might give rise to a violation of section 406 (a) (1) (B) and (D) of the Act. Although section 408 (b) (1) of the Act may provide an exemption for such loans from a plan to persons who are participants and beneficiaries with respect to the plan, there is no relief for such loans to employees of service providers or unions that are related to the plan. The provision of additional loan administration services by a servicing mortgage banker might give rise to a violation of section 406 (a) (1) (C) and (D) of the Act. However, the statutory exemption provided in section 408 (b) (2) of the Act appears to permit such transactions.

This list is, by no means, intended to be exhaustive. It is illustrative of the problems and dangers pension fund managers face if they try to enter the mortgage market. The effect is to inhibit the entry of pension funds into the area of housing finance.

EXEMPTION RELIEF

The mechanism ERISA establishes for providing relief from the prohibited transaction rule where it is overly restrictive has not worked efficiently for housing finance. Under Section 408 of the Act (29 USC 1108), the Secretary of Labor has authority to grant exemptions for classes of fiduciaries or classes of transactions. The Secretary has issued a class exemption with regard to mortgage-backed securities (Prohibited Transaction Class Exemption 81-7, January 18, 1981) and has proposed for comment a class exemption for whole mortgages (46 Fed. Reg. 58773, Dec. 3, 1981).

The Mortgage Backed Security Exemption

The class exemption regarding certain mortgage-backed securities was welcomed by the housing finance industry. The exemption allows, under specified conditions, transactions between plans and parties in interest involved in the origination, servicing, and administration of certain types of mortgage pool investment trusts and the acquisition by plans of certain mortgage-backed securities. It does not address all types of mortgage pools and mortgage-backed securities, however, and it took several years and substantial expense to have the Department issue the exemption.

While the Department of Labor was considering its rule, which clears the basic immediate purchase and sale of securities backed by first lien mortgages, the market was developing more sophisticated variations that offer better investment opportunities. As the President's Commission on Housing noted in its January 6, 1982 preliminary report, the exemption does not specifically authorize contracts for forward delivery of mortgage-backed securities. An agreement to sell or purchase at some forward date at a price fixed now allows the issuer to originate loans for inclusion in the pool backing the security with a knowledge of what the future price for the security will be. A mortgage banker thus can set its lending price in the primary market, where it makes loans to homebuyers, based on the price it will receive in the secondary market when it sells the loan using the device of the mortgage-backed security.

Also absent from the exemption are mortgage pools composed of junior lien mortgages. Second mortgages are increasingly being used to finance the purchase of houses without paying off the low interest rate first mortgage on the house. Nor does the exemption include shared appreciation mortgages, an increasingly attractive instrument in which the investor shares with the borrower in whatever equity appreciation the property enjoys.

The Pending "Whole Mortgage" Exemption

The "whole mortgage" exemption was requested in 1980. It is now pending for comment. It has serious flaws.

In part I of the proposed exemption , subsection A would limit the mortgage financing to purchasers of new single-family residential dwelling units. While MBA has no objection to construction-related pension funds implementing a new home requirement, such a requirement should not be generally mandated. Mortgages on existing housing offer the same excellent investment opportunity as mortgages on new housing and should not be discriminated against on a broad basis. Construction-related pension funds should also keep in mind the importance of a viable resale market in existing houses, since the majority of new home purchasers "trade up" from an existing home.

Part I of the proposed whole loan exemption, unlike its mortgage pool investment trust counterpart (part I, subsections C and D), fails specifically to address mortgage loan servicing transactions. These transactions were included in the mortgage pool exemption because of the possibility that a pool sponsor, such as a mortgage banking firm, providing servicing for the loans that it sold to a plan, could technically come within the definition of a party in interest, and would thus be prohibited from making any subsequent loan sales to the plan. In view of the fact that the servicing of whole loans might also come within the definition of a "party in interest," and because we do not feel that a subsequent sale of mortgage assets by a mortgage servicer can properly be considered "incidental to the furnishing of such service," a specific mention of loan servicing transactions should be included in the whole loan class exemption.

In part II of the proposed exemption concerning conditions that apply to the transactions described in part I, subsection C requires that the decision to issue the commitment to purchase mortgages must be made on behalf of the plan by an established financial institution. Although a pension fund should have the discretion to retain a financial institution (meeting the criteria established in this subsection) to advise the plan on potential mortgage investments, it is equally important to allow a pension fund to make this decision itself. To ensure competitiveness in offerings, it would be most desirable for the financial institution originating the loans to make the presentation directly to the plan. Using this method, the plan can select among proposals presented from a variety of mortgage originators, thus assuring the competitiveness of these proposals. MBA, therefore, recommends that the "third party" investment decision requirement be dropped from the proposed regulation, or at least reduced to a suggestion.

Perhaps a more viable approach to the third party investment decision issue could be found by adopting the mortgage pool class exemption's provision (part I, subsections A (1) and B (1) regarding such decisions. That exemption requires a third party decision when the sponsor of the pool is also a fiduciary with respect to the plan. In cases where the pool sponsor is only a party in interest, no such third party decision would be required. Such a compromise would provide adequate protection in cases where self-dealing could be a problem, while allowing the fullest measure of competition in all other instances.

Subsection E of part II would limit the exemption to transactions involving first liens, and would therefore exclude second liens on single-family residential properties, a very important segment of the residential mortgage market and a high yielding investment for pension funds. Properly underwritten, fully amortizing second mortgages can offer investors a very attractive combination of safety, high yield, and short maturities, and should be permitted to allow for a fuller diversification of funds' asset portfolios.

Subsection B of part III (Definitions) narrowly defines an "established financial institution" as "an investment manager described in section 3(38) of ERISA with respect to the plan;" or a Federal savings and loan association. We believe that this narrow definition results in two major problems. First, this definition fails to include such established financial institutions as mortgage bankers, mutual savings banks, and state chartered savings and loan associations. Thus, no mortgages originated by these groups can be sold to the plan. The exclusion of these major lending groups would result in a reduction of competition among lenders for plan commitments, which may result in increased costs. Second, the exemption in general, and the proposed definition in particular, also fail to specify that the financial institution should be both a knowledgeable and active participant in the residential mortgage market. This is especially important if the financial institution serves as an investment advisor to the plan, and is expected to give sound and timely advice on potential mortgage investments.

MBA's recommended solution to both of these problems is to replace the "established financial institutions" with a new group, which would be broadly classified as "qualified financial institutions" and would be defined as: "any financial or business organization regularly in the business of originating residential mortgage loans."

A second approach to defining "qualified financial institutions" would be to enumerate the major groups of financial institutions and business organizations involved in mortgage origination activities, and also include a general requirement relating to the institutions' mortgage market experience, such as: "any financial institution or business organization regularly in the business of originating residential mortgage loans, and which is also a member of one of the following categories:

A an investment manager described in section 3(38) of ERISA;

B a Federal savings and loan association;

C any lender approved by the Secretary of HUD for participation in any mortgage insurance program under the National Housing Act;

D any state bank as defined in Section 3(a) of the Federal Deposit Insurance Act (12 USC 1813(a));

E any mutual savings bank as defined in Section 3(f) of the Federal Deposit Insurance Act (12 USC 1813(g));

F any savings bank as defined in Section 3(g) of the Federal Deposit Insurance Act (12 USC 1813 (g));

G any building and loan, savings and loan, homestead association, or cooperative bank organized and operated according to the laws of the State, District, Territory or possession in which they are chartered or organized and whose accounts are insured pursuant to Title IV of the National Housing Act (12 USC 1724-1730); and

H any lender approved by FNMA or the FHLMC as a qualified seller/servicer.

Subsection C of Part III defines a residential dwelling unit as "an owner-occupied, detached house, townhouse, condominium, or unit in a multi-unit subdivision (planned unit development)." Considering the excellent investment quality of properly underwritten two- to four-unit residential properties, such properties should be included as allowable investments. The language in the proposed exemption defining residential dwelling units should be replaced with the definition contained in the Department of Labor's class exemption involving mortgage pool investment trusts (part III, subsection E). The definition would real as follows: "'single-family, residential property' means non-farm property comprising one- to four-dwelling units, and also includes condominiums."

CONCLUSION

Each of these points has been made to the Department of Labor, and we hope it will correct its proposed ruling accordingly. The significance here, however, would not change if the corrections are all made. The defects in the "whole loan" proposal, the omissions in the mortgage-backed security exemption, and the time and the expense incurred to produce each of these inadequate rulings demonstrates the failure of the prohibited transaction exemption mechanism now in ERISA, as interpreted by the Department of Labor, to encourage pension plan investment in the highly sophisticated and rapidly developing housing finance market.

The President's Housing Commission, after reviewing the history of ERISA, observed in its January 6, 1982 preliminary report, "It is not reasonable to prohibit the development of relationships that arise in the normal course of business between the pension plans and such parties as loan originators, sellers, servicers, and mortgagors." MBA therefore applauds efforts to return ERISA to reason, and opposes enactment of legislation incorporating ERISA's interference with the mortgage market.

MBA appreciates the opportunity to submit these comments and would be happy to furnish any additional information if needed.

Sincerely,

James F. Aylward

James F. Aylward, CMB
President

JFA/pfw

National Governors' Association

Richard A. Snelling
Governor of Vermont
Chairman

Stephen B. Farber
Executive Director

May 10, 1982

The Honorable John Chafee
Chairman, Subcommittee on Savings,
Pensions, and Investment
3105 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Chafee:

Because of schedule conflicts, I was unable to appear at the March 29 hearings held by the Subcommittee on Savings, Pensions, and Investment Policy on the Public Employee Retirement Income Security Act of 1981 (PERISA). As you know, Senator James Clark delivered the joint testimony of the National Governors' Association and the National Conference of State Legislatures at the hearing, so you are aware of the Governors' position and already have a copy of our pension guidelines and policy statement. However, because the issue is an important one to the states, I wanted to communicate my personal views on the subject for your consideration and for the record of the subcommittee hearings.

As the foundation for my comments, I wish to emphasize the profound improvements in and careful oversight of public pension plans that states have undertaken in recent years. These improvements have been stimulated by a range of forces, including concern by Governors for the w l-being of retired citizens, public demands for accountability in the expenditure of tax dollars, the growing number of state and local employees, and the fiscal constraints faced by states. They have also been stimulated by studies of public pension plans, including those undertaken by the U.S. Congress. In any case, the evidence of this progress is already in the record of your hearings. It is cited in the NGA pension guidelines, in Senator Clark's testimony, in the Urban Institute research, and elsewhere. I urge you to keep it in mind as you consider the appropriate role of the federal government in regulating state and local pension plans.

In preparation for NGA testimony on PERISA, I have contacted a number of Governors to determine their reaction to the proposed legislation and the effect it would have on their pension systems. My preliminary reading is that the states are in close compliance with the NGA guidelines regarding establishment and amendment of pension plans, funding, and audits and that substantial progress has been made in the area of reporting and disclosure. For your information, I am sending you a copy of letters I received from Governor Garrahy of Rhode Island and Governor Lamm of Colorado describing their pension plans.

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My opinion, which is shared by my colleagues, is that federal regulation of state and local pension plans is highly undesirable. Too often we have seen creative state-developed programs--which were designed to be responsive to the particular state needs--stifled by federal paperwork requirements. I am concerned that if the provisions of the PERISA bills are enacted, precious state resources will be used to write reports and file papers rather than to continue to develop innovative ways to serve better the participants in the state and local retirement systems. It would be regrettable indeed if the improvements in state and local pension practices--which have been stimulated in part by the oversight activities of Congress in recent years--were inhibited by cumbersome federal legislation. I believe this is what would happen if either of the bills being considered by the Subcommittee is enacted. We strongly oppose the preemption of state procedures called for in S. 2105 and S. 2106.

However, in the event that PERISA legislation is believed to be necessary by the Subcommittee, I wish to make three recommendations for your consideration:

1. The requirements, particularly as they relate to reporting and fiduciary issues, should be vastly simplified. The prescriptiveness of the legislation as currently written should be reduced, with more flexibility left to state and local governments as to how they meet the goals of the legislation.

2. The long-standing uncertainty of the role of the Internal Revenue Service with respect to public pension plans should be resolved. S. 2105 accomplishes this by providing that plans in compliance with the legislation are automatically considered to be qualified. This should be included in any legislation reported by the Subcommittee.

3. The intrusive nature of the legislation is mitigated somewhat by the provision in S. 2105 for a Governors' certification of compliance with federal standards. Incorporation of such a provision in any legislation enacted by Congress would permit Governors to maintain accountability for state and local pension programs where it should be--at the state and local level. However, the provisions as written could be simplified and improved. First, the section should be made consistent with existing certification provisions (as in the revenue sharing act) where the Governors' statement is presumed to be accurate, without agency review. Upon receipt of a complaint, agencies initiate informal factfinding followed by hearings and negotiated resolutions. Second, the certification should be applicable to all sections of any PERISA legislation, not just those dealing with reporting and disclosure.

Mr. Chairman, it is our view that the proposed legislation is in conflict with the current efforts underway to limit unnecessary federal intrusion, reduce federal paperwork, and place accountability at the level of government which is best able to achieve the necessary results. S. 2105 and S. 2106 are not consistent with these very desirable goals. I urge you to oppose enactment of the Public Employee Retirement Income Security Act of 1981.

Sincerely,

George R. Ariyoshi

Governor George R. Ariyoshi
Chairman, Subcommittee on
Public Retirement Systems

Statement of

Bernard Rosen

Associate Director

Office of Management and Budget

Office of The Mayor

City of New York

to the

Senate of The United States

Committee on Finance

Subcommittee on Savings, Pensions and Investment Policy

Date of Hearings: March 29, 1982

Subject: PERISA

Statement of

Bernard Rosen

To the

Senate of the United States - Subcommittee on Savings, Pensions and Investment Policy

Chairman Chafee, Members of the Senate Savings, Pensions and Investment Policy Subcommittee.

Members of the Committee, my name is Bernard Rosen and I am the Associate Director of the Office of Management and Budget of the City of New York testifying on behalf of the Director, Alair A. Townsend. On behalf of Mayor Koch and the people of the City of New York, I want to thank you for the opportunity to discuss S.2105 and S.2106 - proposed legislation that would govern public employee pension plans - and its significance to the City of New York.

The City maintains five major actuarially funded retirement systems which cover more than 90% of its employees. The City also contributes to three other actuarial systems, maintains six non-actuarial retirement systems, provides other supplemental benefits to retirees and makes contributions to certain union annuity funds.

The City allocates approximately 9% of its expense budget to these systems. In fiscal year 1981 the City's expense budget costs for pensions were in excess of $1.3 billion. Of that amount over $1.2 billion was spent on behalf of the five major actuarially funded systems. Membership in these five systems on June 30, 1981 consisted of approximately 294,000 active members, of whom approximately 84,000 were employees of certain independent agencies (and not paid for directly by the City), and approximately 142,000 retired members.

At his previous testimony on PERISA on September 30, 1980 before the House of Representatives' Task Force on Welfare and Pension Plans the former Director of the New York City Office of Management and Budget, James Brigham, traced the development of budgeting and contributing for pensions by the City and pointed out that this area has undergone extensive reforms, especially over the last several years.

The Pension Task Force of the Mayor's Management Advisory Board - the Shinn Commission - recommended certain changes in the mid-1970's that were enacted into legislation. The main goal of these recommendations was to improve the fiscal integrity of the City systems. The recommendations included the establishment of updated economic assumptions and revisions of certain actuarial assumptions as well as the method of funding the systems. These changes were implemented over the course of a five-year phase-in at a substantial cost to the City.

In the last year, the City sponsored and has seen enacted into legislation provisions that provide for a truly balanced City budget- one that is in accordance with generally accepted accounting principles, known as GAAP, including the financing of the City pension funds. The City now budgets pension costs on an accrual basis which entails full employer contributions on the basis of current costs. Also included in the City's legislation providing for pension funding in accordance with GAAP was a more current revision of the underlying economic assumptions with respect to interest earnings and wage levels. These major changes were accomplished in fiscal year 1981, one year earlier than required by law. The additional pension costs incurred by the City in fiscal year 1981, as a result of the elimination of all deviations from GAAP was $128 million.

The City has embarked on a program to amortize the final remaining liability with respect to its pension funds, the excess between GAAP costs and the City's contributions in past years. This is an additional funding measure not required by GAAP which will add over $.5 billion in additional pension costs over 40 years.

Thus, in its accounting, budgeting and contributing policies and practices the City is in the vanguard, on a nation-wide basis, in this area.

I will address sections of the proposed legislation today which trouble the City Administration and which, we feel, would add confusion, and unnecessary regulation, as well as possible economic hardship to our City.

Restrictive Percent Limitations

Of major concern to the City are the sections of S.2105 and S.2106 that deal with setting percentage limiations on pension plans with respect to the acquisitions of employer securities.

Since 1975 and the onset of New York City's financial difficulties the federal government has, pursuant to federal legislation, participated in programs for the financial assistance of New York City. Since that time the City pension systems have also participated substantially in programs to assist the City and, in fact, the federal government has insisted upon this form of local participation in these financing programs.

Pursuant to federal legislation, the federal government provided seasonal loans to the City in the 1976, 1977 and 1978 fiscal years during a period when the systems purchased $3.5 billion of City and MAC obligations pursuant to an agreement which, together with other measures, provided an integrated program of financial assistance to the City for that three-year period. In 1978 the federal government again participated in a program of financial assistance for the City for fiscal years 1979 through 1982. Again the systems also participated in the program. The federal assistance in the form of loan guarantees was expressly conditioned on the systems' purchasing both federally guaranteed City bond bonds and $625 million of MAC bonds. This participation of the systems was explicitly required by the federal legislation authorizing the guarantee of City bonds.

Neither the City nor MAC has ever treated debt held by the City pension systems less favorably in terms of payment than debt held by other entities. Neither the City nor MAC has ever defaulted or delayed payments on bonds held by the systems.

Public Law 95-497, enacted by the Congress in 1978, allowed the City pension systems to have 30% of their assets at June 30, 1982 invested in City and MAC obligations. In fact the systems now hold 22% of total assets in City and MAC bonds, substantially as a result of the financing assistance programs entered into in 1975 and again in 1978. The federal government participated in both programs pursuant to legislation. Prior to those programs the pension systems held 7.7% of total assets in City obligations and MAC obligations did not exist.

The City is aware that economically it is not desirable for City pension systems to hold City bonds. In order to make City bonds a reasonable investment for the systems, the City is obliged to pay interest at a rate comparable to rates paid by taxable obligations that the funds would otherwise invest in since the funds themselves are not subject to income taxation. This is a higher rate than the City would expect to pay to a purchaser who could benefit from the tax exempt nature of City obligations. The funding standards which by statute dictate the City's annual contributions to its pension systems would in any case require a higher City contribution if the systems' investment income were reduced because the City was paying a lower than market rate on its bonds held by the systems. The rates paid by the City on bonds purchased by the systems since 1978 have been comparable to taxable rates.

Despite the economic desirability of reducing the City pension systems' holdings in City and MAC bonds, the market for City bonds is still limited. Even if the trend of the last several years continues, and the market for City obligations continues to increase, the City pension systems' holdings in City and MAC paper are likely to be over 10% until 1987.

The bonds now held by the pension systems contain a number of City and state covenents, as well as federal guarantees on a large portion. It is quite possible that, prior to the maturity of these holdings, circumstances may require a variation in one or more of these covenents or other adjustment in the terms of bonds which would be acceptable both to the city or MAC and to the pensions sytems. To accomplish such a change might require the defeasance or exchange of bonds held by a pension system for similar City or MAC bonds embodying the desired change. Under the terms of the proposed legislation, no variation can be granted from the limitations on purchase, even if required for some technical transaction which would not increase the percentage holdings of a particular fund.

Nor is there recognition that circumstances may occur, as has been demonstrated by the experience of the City of New York, where despite considerations to the contrary, the Congress has found it appropriate to require participation of pension funds in the financial assistance of a municipal entity.

With a foundation of responsible fiscal policies the performance of the City and its pension plans continues to improve. The City is subject to more oversight bodies than any other municipality in the United States and the City's pension plans are subject to even more review.

Both bills provide broad discretion in the body responsible for administering the provisions of the bill to waive requirements with respect to reporting and disclosure upon a determination that this would be "appropriate and necessary in the public interest, and...consistent with the purposes of this Act."*

Circumstances occur which are unforeseeable at the time of enacting a regulatory program of this kind which may make provisions which now may seem practicable and desirable impractical and detrimental to the interests of the employees and pensioners whom you are trying to protect. We recommend very strongly that the provisions for waiver of certain requirements now existing in these bills be broadened to similarly encompass investment criteria. We recognize that any such waiver would most probably be rare and would only be obtainable when the public interest being served by this legislation clearly and unequivocably required it. We have mentioned above the possibility of a provision in an existing covenant running with City bonds now held by our pension funds necessitating an exchange without a change in the economic position of the funds. A waiver could accommodate such a transaction. A waiver provision could also accommodate other future events. We believe that such a provision would not injure the interests this legislation is trying to serve. We also believe that where regulations are as tighly drawn as these are, in a realm as complicated as the administration of public pensions, a broadened waiver provision as we have described is vital to enable the best interests of public employees and pensioners to be served in whatever future circumstances may arise.

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*S. 2105 Section 1115(a)(3)(A)&(B)

Administration of Proposed Provisions

S.2105 and S.2106 would place the responsibility of administering PERISA provisions with either an Employee Benefit Administration (EBA) or the Department of Labor.

Movement in this direction is a federal effort to directly regulate state and local retirement systems. A controversy emerges as to which level of government is best able to assure the stability and the integrity of state and local retirement systems. As stated in James Brigham's testimony, the City has been very concerned about excessive Federal mandates and control on local governments. In fact, New York City's pension plans are audited and regulated by more stringent rules than PERISA would require.

The issue that the City finds distressing is the danger that the proposed legislation would pre-empt local government in this area. When ERISA was established there existed a clear cut need for uniform and standardized nation-wide criteria due to the interstate implications of so many private corporations.

If the Congress decides it is necessary to legislate standards for public plans, we urge that the federal role be only to develop standards. In ensuring that state and local governments meet, or in New York's case exceed, those standards the federal government should defer to the locally provided regulations.

The City's own public pension disclosure process is extremely thorough. It includes financial statements and reports, actuarial analyses (including certifications and valuations), disclosures in official statements, audits by agencies within the City, annual reports, and audits by independent accountants.

Specifically, the following professional organizations audit the five actuarial systems for the City:

Arthur Young & Company, Independent Certified Public Accountants, are responsible for the examination of the five systems' financial statements and annual reports in accordance with generally accepted auditing standards in order to report whether the financial statements are presented in accordance with generally accepted accounting principles according to Public Law 95-497 Section 2e(11). Some of the major procedures performed in this audit include:

Assets

Confirmation with the financial institution that acts as custodian of the City pension fund assets, of all plan investments and securities at the end of each fiscal year; testing of selected financial transactions such as interest and dividends and purchases and sales of securities.

Benefits

Annual review and check of a selection of beneficiary computations, in accordance with governing statutes, for new beneficiaries

Required Contributions and Actuarially Determined Liabilities

Review the work of the City Actuary in terms of actuarial methods, reasonableness of assumptions and integrity of the data used.

In conjunction with these audits, management letters are sent to each of the systems. The management letters delineate the conditions within each system requiring corrective actions.

The New York State Insurance Department conducts quinquennial audits of the five major actuarial systems. Also, according to Section 36-a of the New York State Insurance Law annual statements are filed with the Superintendent of Insurance on March 1 relating to the previous fiscal year. The degree of specificity required by these particular statements is very great. They form the basis of a comprehensive accounting of total City pension system income and disbursements as follows:

- Assets (including data on real estate, mortgage loans, stocks, bonds, other collateral, dividends, rents, cash)
- Income (including member contributions, loans, City contributions, interest income from mortgage loans, collateral loans, bonds, stocks and other sources)

- Disbursements (including retirements, deaths, resignations, loans, transfers to other systems and other disbursements).
- Liabilities (including accumulated contributions of members, present value of benefits payable, benefits due and unpaid).

Information is also provided to the Superintendent with respect to the actual interest earnings of the City funds vis-a-vis projected earnings, the adequacy of the actuarial assumptions as well as data relative to the unfunded accrued liabilities for members' benefits. In addition, the New York State Superintendent of Insurance is conducting a series of joint studies with the Director of the New York State Division of the Budget concerning actuarial assumptions, accounting practices, administrative efficiency, investment policies and financial soundness in order to establish financial standards for the major public retirement systems within the state.

Deloitte Haskins & Sells, pursuant to Section 349 of the New York City Charter, will examine the City's financial statements (including the City's pension costs) for the 4 years 1982 through 1985. For the fiscal years 1978 through 1981 this examination was conducted by a consortium of independent accountants led by Peat, Marwick, Mitchell & Co.

In their review, Peat, Marwick, Mitchell & Co. first looked to the professional qualifications of the City Actuaries performing the valuations and certifying the results. The calculations associated with the City pension plans are carried out by Enrolled Actuaries under the standards established by ERISA. Secondly, the auditors looked at the reasonableness of the methods and assumptions used in the actuarial calculations. Thirdly, the auditors reviewed the reasonableness of the results and the consistency of those results with prior periods. Additionally, the auditors ensure that the methods and diclosures comply with the Accounting Principles Board Opinion No.8 and with the Statements of Financial Accounting Standards No. 35 and No. 36.

The costs associated with further reporting requirements would incur significant mandatory administrative expenses which would ultimately be borne by the public.

The proposed legislation would require, at a very substantial cost, a virtual overhaul of the system by which payroll and other employee-related information is structured and transmitted. A much more sophisticated approach to the City's payroll data base would be required. In addition, a comprehensive mechanism for interfacing City and independent agency information would have to be created to comply with PERISA.

Currently, the City is developing a new Payroll Management System (PMS), primarily for mayoral agencies, which would more fully computerize and streamline the City payroll and time-keeping operations at a very substantial cost. In our discussions with the administrators of the City pension systems PMS would have to be even more elaborate and expensive for PERISA-related needs.

Total start-up costs, in terms of complying with S.2105 and S.2106, could easily amount to $5 million for the five City systems. This estimate excludes the much more costly enhancements to PMS and development of a suitable interfacing mechanism with the independent agencies that PERISA would require.

Summary

Thus, in summary, we have stated that New York City's pensions are budgeted and funded in accordance with generally accepted accounting principles and are subject to a multitude of regulatory requirements which have been in place for a number of years. In addition, each of the five major systems has a Board of Trustees who are charged with exercising their fiduciary responsibility, and, are required to apply their independent judgments to issues that may arise. One of the primary concerns in instituting disclosure requirements is to inform employees of the geenral condition of the retirement system. In private plans ERISA standards are necessary since employees and their representatives may not be able to participate in the policy-making process since the employer makes these decisions. Thus, it is likely that in most private plans where a decision on investments in employer securities is to be made, the employee has no voice in this decision. The City pension plans, unlike the private ones, include a very substantial degree of employee representation and input. The employee representatives are involved in all decision-making including actuarial and demographic assumptions as well as financial investments.

The imposition of this legislation could pre-empt or interfere with the abilities of those so charged in localities to carry out their fiduciary responsibilities to their fullest ability in each local context.

In this light, I urge you to consider the negative implications of enacting either S.2105 or S.2106 and the possible consequences of the limitation on purchases of employer securities without providing for a variation or waiver from this provision in the proposed legislation.

SUPPLEMENTAL DATA

Percent of Total Assets of the New York City
Retirement Systems in New York City
and MAC Securities
Fiscal Year 1975-1986
($ In Millions)

End Of Fiscal Year	Total Assets	Amount Invested in New York City & MAC Securities	% of Total
1975	$ 8326	$ 641	7.7.%
1976	9002	1844	20.5
1977	9970	3043	30.5
1978	10465	3425	32.7
1979	11291	3454	30.6
1980	12493	3460	27.7
1981	13467	3318	24.6
1982	15143	3342	22.1
1983	16719	2995	17.9
1984	18295	2682	14.7
1985	19871	2414	12.1
1986	21447	2239	10.4

Notes: (1) Total Assets include assets of the variable annuity program

(2) Total asset data for 1982-1986 was estimated by the Office of the Actuary

(3) Investments in New York City & MAC Securities assumes purchase of $150 million of City Bonds on 2/18/82 and provides for redemptions based on maturity schedules of the respective holdings. It assumes no sales of these securities prior to maturity.

New York City Retirement Systems
Purchases of New York City & MAC Securities (A)
FY 1979-1982
($ In 000)

Date	Security	Amount Purchased	Interest Rate
11/17/78	City Bond	$ 100,000	8.9%
11/17/78	MAC Bond	60,375	8 3/8%
2/15/78	City Bond	50,000	9.5%
Total Purchases FY 1979		$ 210,375	
8/30/79	City Bond	$ 100,000	9.25%
8/30/79	MAC Bond	73,905	7 7/8%
12/14/79	MAC Bond	150,320	8 3/4%
1/3/80	City Bond	75,000	10.75%
2/21/80	City Bond	50,000	11.40%
Total Purchases FY 1980		$ 449,225	
10/2/80	City Bond	$ 150,000	11.55%
10/2/80	MAC Bond	125,295	10 3/4%
6/4/81	MAC Bond	98,980	11 3/8%
Total Purchases FY 1981		$ 374,275	
10/23/81	MAC Bond	$ 116,125	13 3/8%
11/19/81	City Bond	150,000	15.9%
2/18/82	City Bond	150,000	15.0%
Total Purchases FY 1982		$ 416,125	
Total City Bonds		$ 825,000	
Total MAC Bonds		625,000	
Total Purchases 1979-1982		$1,450,000	

(A) Pursuant to Federal Guarantee legislation and MAC Bond Purchase Agreement.