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SECOND PANEL DISCUSSION ON
PRIVATE PENSION PLAN REFORM
VESTING AND FUNDING PROVISIONS; TERMINATION INSURANCE; PORTABILITY; AND FIDUCIARY STANDARDS

COMMITTEE ON FINANCE
UNITED STATES SENATE
RUSSELL B. LONG, *Chairman*

TESTIMONY TO BE RECEIVED JUNE 4, 1973
BY THE
SUBCOMMITTEE ON PRIVATE PENSION PLANS
GAYLORD NELSON, *Chairman*

JUNE 4, 1973

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The Urgent Need But Poor Prospects
for
Private Pension Reform

Testimony

of

Professor Merton C. Bernstein*

before the

Subcommittee on Pensions

of the

U. S. Senate

Committee on Finance

June 4, 1973

For release June 4, 1973

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The Committee's invitation to appear as a panelist with such distinguished colleagues is appreciated. Private pension reform is urgent--but measured by the proposals before Congress its present prospects are poor.

In 1962, Burlington Mills, Inc. of Burlington, Wisconsin established a pension plan for salaried employees. The corporation board appointed three trustees, one the corporation president, Richard Kinzer, who, with other immediate family members, owned 92% of the company's stock. In the years 1962, 1963, 1964, and 1965, the company made contributions to the plan that varied between $15,000 and $19,000. The last contribution--$800--was made in January 1966. In late 1965 the company decided to move operations from Burlington, Wisconsin to Danville, Kentucky. A few plan participants were offered jobs in Danville but without salary increases or moving expenses other than use of a company truck.

The last, quite small, contribution to the plan was made in January 1966 and on February 20, 1967 corporate minutes recorded that no further contributions would be made, but the plan was not terminated until late July 1967. In essence, the decision was made by Mr. Kinzer, the company president, plan trustee and controlling stockholder. A dissenting trustee was simply removed.

Meanwhile, the company fired some employees; others sought and found other jobs. The delay in terminating the plan meant complete losses to some participants but enabled President, Trustee, Principal Stockholder Kinzer to improve his share from $15,000 to $26,000--at the least. A state court suit proved totally unavailing.

This story illustrates several--but not all--of the serious shortcomings of private pension plans:

(1) Length of service eligibility conditions--supposedly justified as a means of retaining valuable employees--frequently defeat pension eligibility for employees who are denied the opportunity to comply;

(2) employer control of pension trustees; (in other situations union or unions and management may be in this position);

(3) employer domination of crucial decisions adversly affecting employees but favoring management;

(4) although § 401(a)(7) of the Internal Revenue Code mandates vesting of all pension credits when a plan terminates, IRS regulations and procedures do not protect employee interests this code provision (§ 401(a)(7) supposedly serves);

(5) the courts fail to protect employee interests against employer self-serving plan language and actions.

These themes will be developed in this presentation.

The Cost of Pension Plans - To Employees, Employers and the Treasury.

Whatever benefits a plan pays out over its life constitutes the cost of that plan. However, the out-of-pocket contributory costs will vary substantially depending upon the rate of funding and the rate of net earnings on plan reserves (the amounts not needed currently to pay benefits and hence available for investment). The larger the reserves at any given time the smaller will be the out-of-pocket expense. It follows that the larger the contributions made during the early years of a plan, the smaller will be the total contributions required and the greater the amount paid by earnings on reserves. Of course, there is an opportunity cost to be considered--the earnings from some other investment otherwise available.

However the tax free nature of earnings on plan reserves, which become available for more tax free investment, make the pension reserve investment advantageous. It has been estimated--by Professor McGill and Charles Trowbridge, I believe Dan has told me, that to equal the value of the tax-favored pension investment a non-pension investment would have to generate about twice the earnings.

That considerable advantage comes at a decided cost to the Treasury--and hence to all other taxpayers. Private plan reserves are estimated at $150 billion and their net receipts in 1971 put at $10.3 billion.* Assuming earnings of 5%, the $150 billion in

SEC, "Private Noninsured Pension Funds, 1971", Release No. 2599, June 28, 1972.

reserves would yield $7.5 billion which if taxable at average corporate rates of 50% would generate $3-3/4 billion a year in taxes. Those taxes are not collected for considerable periods and when taxes are applied to pension benefits the rates will be much lower and in some cases nothing. These taxes foregone grow every year as the reserves are augmented. This subsidy--the equivalent of a $3.75 billion expenditure--can be justified only if it serves a high priority public purpose.

But we know that a higher proportion of better paying than lower-paying jobs have pension coverage* and that those who enjoy

Emerson Beier, "Incidence of Private Retirement Plans", Monthly Labor Review 37 (July 1971).

the steadiest employment are most likely to achieve pension eligibility. So, in sober fact, the subsidy mostly benefits those who are and will be best off. Yet those most in need of Social Security supplementation in retirement, low wage and salary earners who experience breaks in unemployment are least likely to be covered and if covered are least likely to achieve benefit eligibility. That puts the justification for the subsidy into serious question.

In addition, those who are under plans but do not earn benefits or earn benefits less than long service persons that is,--the less fortunate--in effect transfer part of their earnings to the long term employees, frequently those with greater earnings,--that is, the more fortunate. It is an odd system, a very unfair system in which those with the least resources and the greatest needs transfer part of their earnings to those with more resources and lesser need.

(This assumes, as most economists do, that contributions for fringe benefits are compensation and that those for pensions are deferred compensation. No one cavils with that characterization for executives.)

What pension reform must do--or it is not reform--is to rectify that unfairness by effectively spreading coverage and effectively assuring that most participants obtain pension benefits for most of their work.

Private Pension Coverage--Inadequate and Less Than Advertised

The latest Social Security Administration report on "Employee Benefit Plans", a yearly affair, is strangely skimpy--and with good reason. It lacks data on plan coverage, explaining that past series probably overstate coverage. A 1972 survey's preliminary result "indicate the need for downward revisions in the [coverage figures in the] health insurance and pension series."*

Walter W. Kolodrubetz, "Employee Benefit Plans, 1971", 36 Social Security Bulletin (No. 1) 27, 28 (April 1973).

Now look at the purported coverage figures. In 1971, the private, non-farm, civilian work force numbered 69 million persons.

Estimates of private pension coverage ranged between 30.7 million*

"Pension Coverage Up 3.2%", Pension & Welfare News 4 (May 1973).

to 33 million by assorted enthusiasts. In the mid 1960's, the National Bureau of Economic Research estimated that in 1963 some 23.5 million participated in plans and that by 1970 the figure would grow to 34 million. (Actually Professor Holland of MIT made several different estimates but the one described became "the" estimate when it was adopted by the Cabinet Committee Report on Corporate Pensions. By 1980 some 42.7 million were to be covered--or 63% of the then private, non-agricultural work force.

That would be no smashing achievement given the universal need for Social Security supplementation. But it should be clear that the 1970 mark has not materialized--a good 13% off the mark, taking the inflated figures that Social Security now tells us must be revised downward.

Note that the President's 1971 message says that "only 30 million employees are covered by private retirement plans."*

Message, H. Doc. 92-182, 92nd Cong., 1st Sess. 2 (1971) reproduced in "Tax Proposals Affecting Private Pension Plans" Hearings before the House Ways & Means Committee, 92nd Cong. 2nd Sess. 7 (1972).

But the Treasury-Labor Intern Report on Plan Termination tells it straight (albeit in a footnote). Private pension plan coverage, it found in an earlier unpublished study, is at the 23 million employee mark. Profit-sharing plans were excluded and with reason--their contribution to retirement income is unpredictable.

Like so much else in private pensions, coverage has been oversold.

Lack of coverage constitutes one major shortcoming of plans today. As noted, all need Social Security supplementation. Several studies show that when production workers with pension-covered jobs lose those jobs, large proportions of them go into jobs with lesser status and pay in which pension coverage is sparse. Quite clearly, the larger the gaps in coverage, the smaller the chances of workers displaced from pension-covered jobs to obtain any pension or an adequate pension income.

Expending Coverage--The Administration and Bentsen Proposals--and Real Reform

A pension reform measure should contain affirmative measures to spread effective coverage. S. 4 does nothing to that end, except to exempt plans with fewer than 26 participants.

The Administration and Bentsen proposals (S. 1631 and 1179)* to permit voluntary tax-sheltered retirement savings, even by those with some pension coverage, will redound to the benefit of those who can best take care of themselves. Experience under foreign voluntary purchase plans show that the well-to-do buy in and the less fortunate do not and cannot. It is a dubious reform that offers yet another tax shelter to those with comfortable means.

The attached data on Canada's voluntary tax-favored Registered Retirement Savings Plans demonstrates that tax payers with higher income enjoy a disporportionate share of the benefits such a system confers. (In applying this experience to the United States it probably would be necessary to raise each category several notches to reflect the generally higher wages and salaries enjoyed "south of the border" as the Canadians say.)

So on Mr. [illegible]or's Table No. 5, (next page) 59.7% of all 1968 Canadian returns were for employees with income under $5,000 but

* This discussion does not distinguish between them; their basic design on this subject is the same.

TABLE NO. 5

REGISTERED RETIREMENT SAVINGS PLANS IN CANADA

NUMBER OF PLANS AND ANNUAL CONTRIBUTIONS BY INCOME BRACKETS

Annual Income	Total Number of Income Tax Returns	Percentage of Returns in Income Bracket	Total Number of Income Tax Returns Bearing R.S.P. Contributions	Percentage of Returns Bearing RSP Contributions in Income Bracket	Percentage of All Income Tax Returns that Bore RSP Contributions	Total Amount of All RSP Contributions	Average Annual RSP Contributions	Average RSP Contribution as a Percentage of Average Income in Bracket
Taxation Year 1968								
Under $5,000	5,074,529	59.7%	24,344	14.1%	0.5%	6,057,000	$ 248.81	10.0%
$ 5,000 - $10,000	2,789,[illegible]	32.8%	64,646	37.6%	2.3%	32,107,000	496.66	7.2%
$10,000 - $15,000	431,098	5.1%	34,659	20.2%	8.0%	29,639,000	855.16	7.2%
$15,000 - $25,000	141,760	1.6%	27,850	16.2%	19.6%	35,659,000	1,280.39	7.0%
Over $25,000	57,491	0.7%	20,395	11.8%	35.8%	39,258,000	1,924.88	4.6%
TOTALS & AVERAGES	8,495,184	100.0%	171,894	100.0%	20.2%	142,720,000	830.29	N/A
Taxation Year 1969								
Under $5,000	5,054,052	56.9%	24,185	11.7%	0.5%	5,319,000	219.92	8.9%
$ 5,000 - $10,000	2,996,659	33.7%	74,677	36.3%	2.5%	36,461,000	488.25	6.9%
$10,000 - $15,000	580,383	6.5%	46,090	22.4%	7.9%	39,506,000	857.15	7.3%
$15,000 - $25,000	180,547	2.0%	35,861	17.4%	19.8%	45,865,000	1,278.97	7.0%
Over $25,000	70,425	0.8%	25,066	12.2%	35.5%	51,431,000	2,051.82	4.9%
TOTALS & AVERAGES	8,882,066	100.0%	205,879	100.0%	23.2%	178,582,000	867.41	N/A

Notes:

1. Contributions to R.S.P.'s are based on earned income.

2. Based on Table 15 of "Taxation Statistics", Catalogue No. Rv.44 - 1970 and 1971, published by the Department of National Revenue, Ottawa, Canada.

N.H.T.
Sept. 15, 1972.

From Norman H. Tarver, "Personal Retirement Savings Plans", ALI-ABA Course on Pension, Profit Sharing and other Deferred Compensation Plans, October 1972.

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less than 1% of all RSP contributions came from this group. But the .7% of taxpayers comprising the over $25,000 taxpayers accounted for 35.8% of returns reporting RSP contributions. Table 6. The 1969 figures are consistent.

When Mr. Cohen testified before the House Ways and Means Committee in 1972, he said that 70% of the benefit of the Administrations voluntary contribution would redound to the benefit of taxpayers with income under $15,000. _If_ this were so (and it is debatable) 30% of the benefit would go to about 8-3/4% of the taxpayers.

But the Canadian data put that 30% figure into real doubt. In 1969, Canadians with over $15,000 income made contributions of $97.2 million to such plans; the far more numerous taxpayers with lower incomes put some $86 million into such plans. So, in raw contributions alone the over $15,000 group obtained more than half the benefit. But, in terms of taxes saved and deferred the advantage of such tax deductible savings to upper bracket persons is greater yet--roughly three times the savings for the $25,000 taxpayer as for the $5,000 taxpayer under _effective_ United States rates.

Basic Pension Plan Misdesign

Although only a minority of plans now use the insurance vehicle, the basic principle of plans is that of insurance. Under the insurance principle, members of a sizable group subject to a common hazard each pay relatively small premiums to form a fund from which the few who actually experience the particular misfortune will receive relatively large payments to compensate for the loss. Fire insurance is the classical example. Many pay so that a few may receive. However, the hazards against which pension plans now purportedly provide protection--retirement from work because of age or disability, and even death after and before retirement--do not affect a small minority but will happen to every plan participant and affect their survivors. The insurance design of pension plans simply does not contemplate widespread, let alone universal, benefit eligibility. This aspect of plans, coupled with their spotty coverage to begin with, means that private pensions will provide only a minority of citizens with benefits in old age despite the fact that all need such benefits.

Pension Plan Losers

A. Those Never Covered--Discrimination Against Young Employees

A basic precept of the Internal Revenue Code is that pension plans qualified for favorable tax treatment must not discriminate in favor of highly paid employees. In aid of this policy, participation requirements call for at least 58% participation by potential eligibles. In fact, several permitted exclusions allow the coverage to fall below 50% of the groups involved without endangering qualification.

All of the bills under consideration permit exclusion of substantial groups in otherwise pension-covered employment. They all discriminate against young employees. Such a policy is both unfair and shortsighted. While young employees tend to more frequent job changing, they need effective pension savings just as much as older employees. Indeed most new plans provide for crediting all or some past service for employees still on board.

These excluded employees, if separated in their early 30's, may well experience many difficulties in achieving pension coverage thereafter.

It may be pesky to keep track of small amounts of service although Social Security does so by quarters of years for over 80 million people.

The pre-participation requirements make ostensible eight year vesting potentially into 15 year vesting requirements under S. 4 (the Williams-Javits bill) the effect upon one who begins work at age 18 of permitting exclusion of years prior to age 25; S. 1179 (the Bentsen bill) ostensibly begins vesting after five years of service; for an employer starting service at age 18--not a rarity in blue collar plans) it in effect requires 17 years of service, but requires counting only five; S. 1631 (the Curtis-Administration bill) permits excluding service prior to age 30 and so operates for younger employees much as the Bentsen bill does.

I urge the elimination of these long and discriminatory pre-participation exclusions. If excluding a year or so can be justified by administrative convenience, once that period is past those years should be included--much as waiting periods in workmen's and unemployment compensation are included for benefits once the waiting period is satisfied.

B. Job Losers

On April 1, 1971 America read that the day before Senators Williams and Javits released a study on private pension plan benefits and forfeitures. It reported (at page 5):

> "Out of a sample covering a total of 6.9 million [pension plan] participants since 1950, 253,118 or 4 per cent have received any kind of . . . retirement benefit . . . ."

That revelation shocked the American public into a demand for private pension reform. S. 4 is co-sponsored by dozens of senators because the public demands that private pensions pay off not to a mere handful but to most participants.

Last February the Senate Subcommittee on Labor released its Interim Report. It reported:

> ". . . 92% of all participants who left
> plans which required 11 or more years of service
> for vesting and 73% of all participants in the
> plans with 10 years or less for vesting . . .
> did not qualify benefits." (St. p. 15).

It should be added that the bulk of plans have vesting requiring 10 or more years of service.

The measures under consideration by the Committee would do little to remedy this appalling picture, as developed below.

While the Bentsen bill apparently would start vesting earlier--after 5 years--it permits delay in participation until age 30 so that for an employee with service beginning before that age the nominal vesting period in fact becomes longer. Moreover, a 25% vesting of 5 years of credits wouldn't amount to a hill of beans--especially after the attrition of inflation between the time of vesting and the time of pay out. Over a 30-year period the value of the vested benefit could be eroded 90%.

C. Women

It comes as no news that more women and a greater proportion of women work (for compensation) than ever before. Almost one-third of the work force are women (almost a million more than a decade earlier).

Quite clearly, single women who work need an income substitute as much as men do. Given the wage and salary discriminations against women, as lower income workers they need a higher percentage of replacement of earned income than do men. Divorced women frequently do not receive alimony and their retirement needs are at least the same as single women; the interruptions to work occasioned

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by family duties will, on the average, prevent their attaining equal Social Security benefits. Widowed women at work may be better or worse off, depending upon whether they have young children at home. The children probably would receive Social Security survivor benefits, but also make full-time work difficult. The categories single, divorced and widowed make up a bit more than a third of working women. (Table No. 346, 1972 Statistical Abstract of the United States 219).

The major new development in work patterns in the past two decades is that an even larger proportion of married women work. In 1971, of the almost 32 million women at work, almost two-thirds were married. And here are the amazing figures: among married couples, there are more families in which both husband and wife work than those in which only the husband works. (Table No. 347, Ibid.) Over age 25, age is not a significant factor in this pattern. Throughout the age 25-54 age groups about half the married couples had both husband and wife earners; only husband worker families varied from 47.4% to 24.8% (the remaining percentages are accounted by families in which the husband and another family member other than the wife works). Among blacks, the proportion of husband-wife worker families is even higher.

This means that in more than half the husband-wife families, the living standards of the family depends upon not only the husband's but the wife's income. One study several years ago reported that the median income of husband-wife families exceeded that of husband only worker families.* In most of these families,

U.S. Dept. of Labor, 1960 Handbook on Women Workers, Women's Bureau Bulletin No. 275, p. 63 (1960).

the Social Security benefit will depend upon the husband's earnings record alone so that a smaller percentage of income will be replaced than in husband only worker families.

These several factors make it mandatory that the private pension system provide an income substitute for working women. In fact, however, a smaller proportion of working women qualify for benefits than do men.

Women--The Losers in the Past--The Losers Still

Pension plan design now effectively excludes women both as potential pensioners and the surviving dependents of employees.

Typically women work for shorter periods of time than men. as the following tables show.

Median Years on Current Job

	All Persons	
Age	Men	Women
30-34	3.9	1.8
35-39	5.8	2.6
40-44	8.4	3.2
45-49	10.2	4.4
50-54	12.6	6.2
55-59	14.7	8.2
60-64	15.1	9.4

Median Years--Selected Occupations

	Men by Age		Women by Age	
Manufacturing	25-44	45 yrs. over	24-44	45 yrs. over
Durable Goods	4.5	14.3	2.4	8.3
Nondurable Goods	5.3	15.4	2.8	9.1
Wholesale & Retail Trade	3.3	8.8	1.5	4.9
Operatives & Kindred Workers	3.8	12.8	2.1	7.7

Source: "Job Tenure" Monthly Labor Review 18-19 (September 1969).

These data demonstrate why such a small percentage of women now qualify for pension benefits. They also show that S. 4 will do little to help them. In wholesale and retail trade where so many women work, the prospects for pension eligibility are negligible. In manufacturing, it is better, but still the bulk of women workers will lose out. Pension plans discriminate against women; the bills before the Committee do little to remedy that discrimination.

Widows make up the bulk of the aged poor. Social Security provides their main money income. It needs improvement. It needs supplementation. But this is an area in which private pensions are dreadfully weak. Conventional vesting will not help them. Vested Clearing House credits could.

The Benefits and Costs of Various Vesting Formulae

Too much of the controversy over vesting has been abstract and overgeneralized. Much has been made of the potentially crippling costs of mandatory vesting. When reduced to concrete terms, the conclusions must be that the proposed vesting of the major bills would yield slight benefits and their costs would be neglible.

The Benefits of Williams-Javits, Bentsen and Curtis bills

The Williams-Javits bill would permit the exclusion of service before age 25. Hence it assures vested benefits for no employers younger than age 33. For employees who begin work before age 25, the vesting requirments are in fact that much longer than the minimum 8 years specified.

For those separated after 8 years/credited service, the benefit vested equals 30% of the normal retirement benefit for 8 years under the formula existing at the time of separation. For an employee under a plan with a benefit of $5 a month per year of service (a moderately good plan in present day terms), the full benefit would be $40 payable at age 65; under S. 4, the same employee would be vested for a benefit of $12 a month--or a yearly benefit of $144. For an employee aged 40 at separation and assuming a modest 3% annual inflation, the purchasing power of the benefit would be equal to about $3 a month or $36 a year at age 65. To call such benefits paltry is to exaggerate their value.

Under either S. 4 or S. 1179 (the Bentsen bill) 10 years of credited service would yield a 50% benefit. Under a $5 a month per year of service plan, a regular retiree with 10 years service would obtain a benefit of $50--the 50% vested separated employee a prospective benefit of $25. If separated at age 40 and with

3% yearly inflation the purchasing power of the benefit at age 65 would be about $6 a month.

S. 1631's rule of 50 would operate in much the same way except that it would vest at later ages--and the attrition by intervening inflation would be proportionately less.

Proposed Vesting Yields Meagre Improvement

All of the major bills yield very little protection to employees with 10 or fewer years of service and they would vest benefits fully only at about 15 years of service. Most 15 year employees will attain normal retirement age. Roughly half the single employer plans already have 10 year vesting and almost all the remaining plans have 15 year vesting. (B.L.S. Study, Monthly Labor Review, July 1970, reproduced in "Study of the Cost of Mandatory Vesting Provisions, etc. U.S. Senate Subcommittee on Labor Committee Print, February 1973 at p. 45. As few such plans provide for vesting short of 10 years, the 5-10 year category really describes 10 year vesting plans; most plans in the 11-15 year category require at least 15 years. However, the age requirements would lengthen these requirements for some employees.)

Mandatory Vesting Cost Slight--Additional Proof of Inconsequential Impact

The cost of these vesting provisions according to the study done for the Labor Subcommittee would be slight--I really mean picayune. This is amply demonstrated by the summary of that study set out on its final page and reproduced on the last page of the Labor Committee's April 1973 Committee print on S. 4.

S. 4's vesting would increase the cost of a plan with 10 year vesting (classified as "Liberal") a grand total of 0.0%--yes, absolutely nothing. Why, because it would effectuate no anticipated measurable improvement over 10 year vesting. (Definitions are found on page 46 of the study.) A plan with a moderate present vesting provision (15 years service and age 45 required) would incur increased costs of from 1/10th of 1% to 3/10ths of 1%. For an employee making $8,000 a year ($4 an hour) that latter would come to $24 a year--a shade more than ten mills an hour--or next to nothing. Note that the same range registers as increases in plan costs of from 1 to 8%. And for a plan with no vesting, S. 4's required vesting would increase costs from .2% to 1.4% of payroll--for an $8,000 a year member that comes to from $16 to $112--or not very much--less than $10 a month for the maximum estimated increase. Note again that as a percentage of plan costs that range registers as a percentage of plan cost increases of 5 to 53%. That means, for the 53% cost increase, that the unchanged plan cost roughly 2% of payroll. Again for the $8,000 a year employee roughly $160--or very little as plan costs go.

Note that the rule of 50 generates increased costs that also are negligible. These formulae are negligible because they would preserve few years of credits and for those few credits salvaged would pay slight benefits.

Some will argue that too exacting a vesting formula simply would lead to more exemptions of plans under the S. 4 machinery for "variances." But the exemption process must be done on notice to employees. It would be salutary for employers and unions to have to declare for employees to see that their plan cannot meet legislated standards. Hopefully some would make the effort to avoid such a claim, whereas on overly modest vesting provision merely lets matters slide. Moreover, there should be a publc record of the fact of inability to comply. If that inability is widespread enough, even more basic changes should be considered.

The Enforcibility of Mandatory Vesting

It is possible that only immediate vesting will work. The Labor Subcommittee's studies show that some employers will fire people to prevent the attainment of vesting. Employees not protected by collective bargaining agreements are quite vulnerable. S. 4 contains a provision (§ 610) declaring it unalwful to discharge a person "for the purpose of interferring with the attainment of any right under the plan [and] this Act . . ."; it is enforcible by civil suit and suit by the Secretary (§ 602 was not modified to conform to § 610 when the latter was added).

This protection is inadequate. The Secretary has been haggard in enforcing the LMRDA. Civil suit is too slow and expensive. The burden of proof would be upon the claiming employee and proof would be near impossible--unlike situations under the National Labor Relations Act where an employer has shown antagonism to unions.

Employees should have protection against discharge without cause, otherwise they will continue to be subject to firing to prevent vesting.

Need for Investigation of Keogh Vesting Provisions

Keogh plans must provide 3 year vesting. I keep hearing stories about secretaries being fired by doctors and lawyers before that third year is achieved. I earnestly suggest this Committee investigate the operation of the vesting provisions of the Keogh plans. Before liberalizing the limits for Keogh plans, Congress and the public ought to be informed what percentages of employee participants have anything to show for the experience.

Beyond that, if only a small percentage qualify, it may lead to the conclusion that only immediate vesting works.

The Pension Clearing House--Indispensable to Employee Protection--Bill Limitations Crippling

A Pension Clearing House is essential to effective employee savings under private plans. Without one control, record of all vested pension credits an employee and his dependents simply may lose track of his entitlements.

Only with a clearing house will those credits be useful to a separated employee. It must be understood that a vested credit under present arrangement has three basic limitations--the benefit is frozen as of the time of separation; the employee must survive to normal retirement age--and survivors have no rights; the credits are unavailable for disability purposes. A vested credit in a Clearing House would grow in accordance with growth in the economy; it would be available to pay benefits for survivors; it would be available to pay benefits in the event the separated employee became disabled.

Consider an employee separated at age 45 under a plan with a normal requirement age of 65. His vested credits would be frozen at benefit levels when he leaves the job--and subject to 20 years of erosion by inflation even before it reaches payment status. For the same years of service employees who stay on the job frequently receive increased benefits reflecting economic growth. Had this bill been in force in 1955 a 1972 retiree separated in that year would be stuck with benefit levels that are a fraction of today's--which are none to handsome.

Under a voluntary Clearing House the employer has no incentive to transfer the credit but has a powerful incentive not to do so. The reasons are technical--but very real.

For any unit of fixed benefit the cost is the benefit divided by the rate of interest. The lower the interest, the higher the out-of-pocket cost of the benefit. Actuaries tend to assume interest rates on reserves that are lower than the going and expected rate. As a result when an employee separates from a job, the cost of transferring the value of the vested benefit is higher than if the vested benefit is paid from the pension fund itself. As a result, employers will not voluntarily transfer the benefit. And by keeping the reserve for the vested benefit in its own fund, the employer can use that frozen reserve and make money on it to lower the cost of paying benefits to other employees. Such earnings make possible higher benefits--so a union will not seek to have transfers to a clearing house made. On the contrary, its effort to get better benefits for employees currently on the job will be enhanced by not making transfers.

A Voluntary Clearing House will not work.

Moreover, the proposed Clearing House, although authorized to operate its own pension fund, is limited in its investments as no other such fund is--it may invest only in bank and savings and loan accounts--with the limits in earnings that result. Moreover, in order to take advantage of FDIC insurance, the Clearing House would have to open thousands of accounts. It would fast run out of banks.

The Clearing House should be empowered to invest just as any trust fund may. Such a fund would constitute a yard stick for private fund performance--which would be very desirable as shall be shown shortly.

The transfer of credits from individual plan to individual plan, while feasible, is awkward, potentially more costly than transfer into the Clearing House Fund, and subject to abuse by the receiving fund.

Needed--Clearing House Plan for Small Companies

The gap in plan coverage occurs mostly in small companies. They cannot afford the charges and time for plan installation. Many more could participate if they could buy into a reliable, low cost plan. The Clearing House should operate such a plan on a money purchase basis so that any level of contribution would be possible. The credits purchased would be immediately vested.

Enlarged coverage would produce--more persons eligible for benefits, higher benefits because more years of work would pay off and lower cost per year for any given level of benefits. All of these advantages flow from early vesting.

Expanded Coverage and Immediate Vesting--Low Unit Cost

As I pointed out in my book about a decade ago:

"A clearing house probably would effect economies in the administration of vesting. More importantly, if a clearing house was widely used, the cost of vesting could be reduced, perhaps substantially. Presently the cost of any vested rights conferred by a plan is borne by that plan alone. Whatever the pattern of employee turnover, under conventional vesting all the money is outbound. Under a clearing house (or mutual bilateral) arrangement some incoming employees would bring funds with them. Of course, the incoming employee would get the full benefit of any funds he brings and so there is no "profit" to the plan he joins on that account. But to the extent that employees arrive with money for credits, the receiving employer is required to contribute less in order to provide any given level of benefits. Therefore the receiving employer can base his plan on a longer period during which pension credits are earned.

"For example many plans limit participation to employees with specified age and/or service. In effect, this can and does exclude considerable periods of employment from pension credit. And, it excludes the earliest years whose contributions would be of the greatest value because they have compounded earnings for a longer period. (See in Chapter VI, under "When Should Coverage Begin?") In effect, under present practice the employer is financing each retiring or early retiring employee's benefits over a period of, say, 30 rather than 40 years. For any given amount of normal or early retirement benefit the employer must contribute more for that employee, and the contributions will have very substantially less earnings and less earnings on earnings--all tax free. Under clearing house arrangements, the older the incoming employee the less is the burden to the receiving employer of providing a decent benefit if that employee brings (in money) some or all of the pension credits he earned elsewhere.

"Some may say this is "taking in each other's wash"--that if each did his own it would be the same. The reply is that it would <u>not</u> be the same because under schemes contemplating the funding of every employees' benefits over a longer period, more of the benefit financing derives from earnings rather than contributions. And it is to be hoped that by reducing the cost of each year of plan coverage more employers would be able to provide plan coverage and transfer value vesting. <u>The more plans utilizing the clearing house and providing transferable credits, the less expensive it would be for each employer to provide a unit of coverage</u>.

"So, for example, the per capita annual costs of providing full vesting to an employee achieving pension credits under a universal transfer-value clearing house for every year of work between age 22 and 65 is less than one third the cost of a 10 year vesting provision as applied to the employee group in Table IX-2 (Chapter IX, with the other assumptions applied there). Obviously the savings for employees who are older when universal transfer-value arrangements are instituted would be less. And the problems of financing benefits for those near retirement would remain what they are today; decent benefits cost proportionally more for them. Quite clearly, however, the savings possible under a universal transfer-value clearing house system are substantial--indeed, dramatic. But, if they are to be gained the system must be put into operation as soon as possible. Of course, the aggregate amount required to finance pension benefits would be greater, but much of the increase would derive from fund earnings. And, as the earnings are tax free to the fund, they are commensurately more productive than if they were used for regular business purposes and put into pension plans later." (FPP pp. 273-274.)

<u>Fiduciary Standards--Proposals Inadequate</u>

The standards proposed are grossly inadequate to protect employee pension interests:

(1) The fiduciary standard is too lax--less exacting than the traditional trustee standard and than the standard prescribed by §501 of the Labor Management Reporting and Disclosure Act; the standard proposed--originating with the American Bankers Association --permits general practice to govern; that is too rubbery and probably too low;

(2) Permit self-dealing (transactions between the fund and the employer) up to 10% of the fund, which can be an enormous amount. Such dealings should be completely banned. Employee pension interests should not depend upon the same enterprise as his/her job. The temptations are too great. It is easier and more effective to ban self-dealing than to attempt to cure dubious transactions after the fact.

<u>The Serious Problem of Shutdowns Without Plan Termination</u>

Every day the newspapers report plant and unit shutdowns throughout the country. They occur in good times and bad as weapons, products and plants become obsolete. Defense cuts, changes in taste, and foreign competition all contribute to these occurrences. American industry and commerce frequently respond to these problems by closing down older units and opening up new ones, frequently hundreds of miles away. Decades ago plant locations were decided on factors that do not govern today. Rank and file employees seldom get the chance to follow their jobs and when they do the option is seldom picked up because of family and other local ties. (Executive and managerial patterns differ.)

In addition, since the close of World War II, company units frequently are sold off and acquired by other companies and new conglomerates. Often these changes are made to acquire tax losses, patents, trademarks, processes, and customers--but not a going concern.

Quite often the shutdowns and transfers are preceded by large scale employee separations. These separations can and do generate what are called "actuarial gains" to the plans--i.e., the separation of employees relieve the plans of potential liabilities on a scale not anticipated in the original assumptions. This in turn enables the employer to reuse money already dedicated to pension purposes. <u>And</u>, if the timing is right from the employer's point of view, it can recapture the money in cash.

These matters are not small potatoes as several cases show. In one unit purchase by an aggressive conglomerate, about 500 of the 580 employees on board at the time of sale were separated in the ensuing 2-1/2 years. The returns applied in that period exceeded

$100,000. This plan had a "10 year vesting" provision (which required an additional five year's service before plan participation began) that benefited only four employees. (See for details FPP, pp. 90, 115-116.)

Reportedly during the death throes of the Saturday Evening Post "staff cuts . . . left a large surplus in the Company's pension fund" leading the financier in charge to announce: "I found ten million dollars . . . " Otto Freidrick, "I am Marty Ackerman," etc. Harper's Magazine 92 at 114 (December 1969).

The crucial point in these situations is that <u>the plans did not terminate</u>. Non-termination can be more deadly to pension credits than plan termination because under the Code and regulations <u>plan termination is supposed to vest all credits</u> whether or not the particular vesting provision of the plan does so. In the absence of a vesting provision or in the presence of a rigorous one requiring 10 or 15 years of service, employees can be separated by the droves with comparative impunity and without anything to show for their plan participation. But plan <u>termination</u> may salvage credits.

Treasury plan funding requirements not only do not require plan termination but delay it. A plan is regarded as terminated when all contributions cease or current costs and interest on unfunded liability are not met. But plan separations reduce liabilities and increase the level of funding, thereby delaying that situation even though the company may be unable to make any contributions. (That's what happened in Burlington Mills.)

The problem also is acute where one unit of several covered by a plan shuts down but the plan itself continues for the other units. Despite large scale employee separations and substantial "actuarial gains" there is no assurance that separated employees will not lose all value for their years of plan coverage.

Two recent revenue rulings (72-439 and 72-510) head in the right direction. In the first, 70% of the employees were excluded from a profit-sharing plan and IRS ruled that as to them there was a "partial termination", thereby requiring 100% vesting of all credits. In the second case, a shutdown of one of two units with 95 of the 165 (57%) plan participants constituted a "partial termination." The latter ruling, though more protective of employee interests, does not vouchsafe any sure guide as to when that protection will occur. It merely states that "a significant number of employees were discharged in connection with the winding up of part of the employer's business." No objective criteria of percentages and the length of time over which a winding up may be regarded as extending appear. Employees deserve more protection; employers deserve to know their liability more clearly.

The regulations on this subject are rubbery and their meaning elusive. IRS practice warrants inquiry. I urge that the Committee consider the dimensions and urgency of this problem which receives no treatment in any of the proposed measures.

Please note the following observation by the representative of the American Bankers' Association made in 1970:

> A more pressing need for vesting has been suggested in situations where the service of employees is involuntarily terminated because a company sells or shuts down a plant or operation. As you know, the Internal Revenue Code provides that upon the complete discontinuance of a plan, all rights of employees must be non-forfeitable and that no money can be returned to an employer until all the liabilities of the plan have been satisfied.
>
> There is no such requirement in the code for full vesting when a plant of operating division of an employer is sold or shut down, although regulations of the Internal Revenue Service indicate that such an event should be considered a partial termination of the plan.

> To effectively protect the interests of employees in such cases, an amendment to the Internal Revenue Code may be needed to require employers to provide in their plans that the sale or shutdown of a plant or operation must be considered a partial termination of the plan with resulting vesting in employees. This can be done without necessarily requiring vesting under other circumstances.

"Private Welfare and Pension Plan Legislation", Hearings before the General Subcommittee on Labor of the House Committee on Education and Labor (91st Cong., 1st and 2nd Sess., 789 at 795 (May 19, 1970)).

I would urge that objective criteria be employed to provide a presumption of termination; e.g., the separation of 50% of a plan unit participants so that the termination can reach back to the inception of the shutdown.

Several recent cases make the point that the Internal Revenue Code, regulations and rulings, directed to qualification for tax purpose, confer no rights upon employee plan participants. This probably is true, in spades, for the termination-vesting provisions of the Code where the plan has not been amended to conform to the statute. Where an employer would recapture substantial funds, the loss of qualification could be a slight impediment to ignoring the tax requirements, especially if the newly incurred tax liability should occur in years of little profit or losses--as often will be the case with firms in trouble that separate large numbers of employees.

Beyond that, as IRS operates, employees do not get notice of plan termination proceedings and consequently do not have the opportunity to present evidence and arguments in favor of an earlier termination date or some other protective action. The Code should require notification to employee and employee representatives of all filings by employers, unions and plan administrators under

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the tax laws and have the standing of parties.

The Code should be declared to confer substantive rights upon employees enforcible by suit. For purposes of uniformity and efficiency, the Tax Court might be the proper initial forum for suit. The Tax Court procedures probably are adequate to allow employees to press their suit close to home.

The Burlington Mills case practically provides a check list of the inadequacies of present law and procedure.

The Treasury Termination Study--A Gross Understatement of the Problem

"The Interim Report--Study of Pension Plan Terminations, 1972" (February 1973) purports to show that the employee losses occasioned by plan termination are slight. Its conclusions--especially as reported in the pension and labor relations press--seriously understate the employee pension losses experienced.

Reportedly 683 plans terminated during the period studied, the first 7 months of 1972. These plans, the report states, "had a total of about 20,700 claimants. About 8,400 claimants in 293 plans lost benefits, or about 40 percent of all claimants in these terminated plans. Typically those who lost benefits lost over 50% of their benefits." (p. 18).

That's not a very reassuring picture. But here is the good news (according to the Report). " . . . about 23 million* workers

*Not a typo. Treasury says 23 million; that excludes profit-sharing plans. Ibid. Note 1, p. 18.

are covered by private pension plans. Thus the 8400 workers losing benefits account for a very small fraction, four one hundredths of one percent, of all workers covered by such plans." (p. 18.) Thus: " . . . the risk of benefit loss over a 10 year period would be 1 percent and over a 30 year period 3 percent." (p. 33.) Before there are huzzahs, that means--even if true--between now and 2003 some 750,000 plan participants will lose more than half their vested benefits from this one cause alone. (I suggest that passing the champagne glasses over the Report was premature.)

But these figures .04% and 3% are untrue. They grossly understate the losses sustained by employees under terminating plans. Because very large groups--the Report fails to give the numbers of people--were separated without vested claims in the years and months preceding termination. Their earned credits achieved nothing for them. Had plan termination occurred earlier (as it probably should have in many of these situations) many more persons would have been recorded as incurring losses. And, it is entirely possible--indeed probable--but the report doesn't enable us to judge, that under the plans with no reported losses those separated before termination was declared would have obtained benefits. The report does not tell us how many Burlington Mills and Griggs cases occurred among the 258 plans with no reported losses. Most of them must have had surpluses, due, to some extent, to those separations prior to termination, i.e., the employer had money returned.

Table 4-6 (attached) shows that during the two years preceding termination 26% of the plans with 40% of the participants experienced contraction in employee participation exceeding 25%. The numbers might be even more impressive. I urge the Committee to obtain these data and reanalyze the losses incurred by employees and the windfall recoupments by employers.

Further I urge the Committee to study the larger issue of windfall recoupments that occur when plans do not terminate.

Table 4-6

Changes in Plan Participation Prior to Termination*

(First 7 months of 1972)

	All Plans		Plans Showing No Decline **				Plans Showing Decline				Plans Showing Decline of at least 25%			
					Percent of Total				Percent of Total				Percent of Total	
	Total plans	Total participants	Number of plans	Plans	Number of participants	Participants	Number of plans	Plans	No. of participants	Participants	Number of plans	Plans	No. of participants	Participants
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
Changes over 5 year period														
All plans	438	16,136	96	22%	642	4%	342	78%	15,494	96%	261	60%	9,569	59%
Plans with no losses	258	8,933	61	24	325	4	197	76	8,608	96	148	57	5,059	57
Plans with losses	180	7,203	35	19	317	4	145	81	6,886	96	113	63	4,510	63
Changes over 3 year period														
All plans	589	18,661	205	35	1,376	7	384	65	17,285	93	263	45	11,107	60
Plans with no losses	337	9,629	114	34	612	6	223	66	9,017	94	153	45	4,925	51
Plans with losses	252	9,032	91	36	764	8	161	64	8,268	92	110	44	6,182	68
Changes over 2 year period														
All plans	632	19,189	332	53	3,405	18	300	47	15,784	82	167	26	7,738	40
Plans with no losses	356	9,864	187	53	1,551	16	169	47	8,313	84	94	26	3,610	37
Plans with losses	276	9,325	145	53	1,854	20	131	47	7,471	90	73	26	4,128	44

Office of the Secretary of the Treasury
Office of Tax Analysis

February 1973

* Participant figures in the table are for the last year of plan operation. The sum of "plans with losses" and "plans with no losses" will not equal "all plans," due to a small number of plans not being included where the benefit situation was unknown.

** None of these plans experienced an increase in participation of 10 percent or more over any of the time periods shown.

The Half-a-Loaf Delusion

The May 1973 issue of The Pension and Welfare News (the major monthly of the pension industry) contains a remarkable editorial which calls for the enactment of private pension reform legislation on fiduciary standards, compulsory vesting, extension of coverage and improved disclosure, and--I deduce--funding and reinsurance. This is a startling and courageous stance for a trade journal.

It notes that "Williams-Javits [i.e., S. 4] has been criticized as not going far enough in reform. The criticism is valid if reform stops with the Williams-Javits bill and goes no further in the next few years . . . ." It concludes: "The momentum for pension reform and for spreading pension coverage to all privately employed people should not be allowed to slacken. Any unfinished business left for this session should not wait five years, much less ten. Employees have waited too long already."*

Editorial: "Politics is the Art of the Possible", Pension & Welfare News, p. 2 May 1973).

"Half-a-loaf is better than none" and "The best is the enemy of the good" are folk wisdom that also work handily to excuse getting less than is needed. In the case of pension reform, if S. 4 is the "half-loaf" the slogans work to excuse legislation that is inadequate and less than can be attained. Even more importantly, the argument that S. 4 is only a beginning that can be improved upon soon is a dangerous delusion.

Popular support for pension reform is massive. Three national television programs have been devoted to the subject during the last two years--their message of frustration, failure and unfairness have taken root.

Pension reform factors are approaching a critical mass. Once legislation results, that mass will be dissipated. As no national pension reform group exists, an entirely new mass will have to be built--without the presence of the few unions (the only organized groups supporting S. 4) seeking reinsurance. Members of Congress know from their own experience that organized anti-reform forces greatly outweigh pro-reform forces. Only embarrassment and conscience--weak enough in the political arena--dictate some action soon.

Assuming enactment of a pension reform measure in 1974, it will have been 16 years since the last reform measure--the Welfare and Pension Plan Disclosure Act (amendments to it have been picayune).

Add to that the fact that the vesting and funding provisions of S. 4 would start to operate only in 1977 thereby delaying any significant experience under the measure until the close of this decade.

The present push for reform is about a decade old. Congressional efforts in this round began with the Joint Economic Committee hearings in the 89th Congress. Here we are in the 93rd, hopefully on the brink. Another such effort--and the same ingredients are <u>not</u> at hand--would take a decade, a decade, that is, <u>after</u> the new law prove' to be as inadequate as analysis now reveals it will be. Moreover, when it comes, reform. legislation takes years more to put into effect and more years yet to affect plan operations.

Realistically, follow up reform could be expected no sooner than a decade after enactment of S. 4--and in all likelihood at least another 16 years may be required. In sum, 1990 is the earliest time to expect follow up reform. By then most of us here (without Congressional pensions) will be in rest homes damning the 93rd Congress for a half-baked half-a-loaf.

In the final accounting, it is not what we appear to have done that counts. When our terms of office and our terms of life are over, we will not be remembered. Only what we actually did will count.

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Statement to Pension Subcommittee of the
Senate Committee on Finance

June 4, 1973

PRIVATE PENSION AND PROFIT SHARING PLANS

Legislative Issues Involving
Vesting, Funding, Termination
Insurance, and Portability

Herman C. Biegel

I. Introduction

The purpose of this paper is to discuss proposed legislation to regulate private pension and profit-sharing plans in the following four areas:

(1) Vesting: the right of an employee to benefits under a retirement plan if he terminates service with his employer before his "normal" retirement date (usually age 65);

(2) Funding: the level of amounts to be contributed and held under the plan to fund the rights accruing to the covered employees;

(3) Termination insurance: a program to insure payment of certain benefits if a pension plan is terminated by plant closing or otherwise; without sufficient funds to pay those benefits; and

(4) Portability: a centralized publicly operated mechanism to keep track of an employee's vested pension credits as he moves from one employer to another, and for payment of those credits upon his retirement.

For several years, Congress has also been considering two other areas of legislation affecting private plans:

fiduciary responsibility and disclosure. While this paper does not discuss these matters in detail, reference should be made to them at the outset.

The core of the fiduciary responsibility proposals is a Federal "prudent man" standard of conduct for those responsible for plan operation, and for the funds held under them. Strict limitations are imposed against the avoidance of that standard by means of "exculpatory provisions" in the plans. The standard would require diversification of fund assets, and prohibit many party-in-interest transactions, including dealings between an employer and its pension fund. Exceptions are made for a level of investment in employer stock, and plans that specifically provide for such investment are not limited to any particular level.

It should be emphasized that, by and large, these proposals are very much in the public interest. Adoption of such standards will do much to correct abuses by some plan administrators, and will increase the confidence of millions of employees that their plans are being operated honestly and competently.

Under the pending proposals for additional disclosure, plan administrators would be required to furnish substantially more information to the Government and to participants about the substantive provisions of their plans, and about the financial operation and level of funding under those plans. Again, without discussing these measures in detail, two points should be made: First, more disclosure is indeed desirable, to increase confidence in the operation of our private system, and to avoid the disappointment and hardship that can result when participants do not understand the limits on the rights provided in their plans. Second, in pursuing this objective, however, Congress must avoid any tendency to require excessive detail and paperwork, particularly in the area of financial data, which would burden plan administrators severely, and would not contribute useful information.

As a background to a discussion of vesting, funding, insurance and portability, it might be helpful to consider the present law, the current legislative consideration of these subjects, and the development of the private pension sector during the last decade.

II. Present Law

At present the tax law provides the only rules for vesting and funding. There are no requirements for insurance and portability, and no major governmental bureaucracies in this area.

Full vesting must be provided when a participant retires, or upon termination of a plan. The other requirements also derive from the rules set forth in Section 401 of the Internal Revenue Code, for "qualification" of pension and profit-sharing plans. A qualified plan may not discriminate in favor of employees who are officers, shareholders, highly-paid or supervisory personnel. 1/ If it appears that the absence of vesting provisions, combined with a heavy turnover of employees, results in having a plan cover only highly-paid or supervisory employees, the Internal Revenue Service reserves the right to challenge the tax qualification of the plan. 2/

There is no statutory requirement that plan liabilities be <u>funded</u> over any particular period. Ironically, the current rules tend to <u>limit</u> funding, by complicated restrictions on the amount of pension contributions that may be deducted each year. As an administrative matter, the Internal Revenue Service does require that the cost of current benefits be funded, together with the interest on the unfunded past service cost, i.e., the cost of benefits for service before the plan was established or improved. 3/ Failure to meet these requirements does not result in the disqualification of the plan for tax purposes. Rather, such a failure is treated as a termination of the plan and the benefits must vest in the participating employees.

While this paper does not deal with problems of administration, it is important to note that the Internal Revenue

Service has developed a substantial capacity and expertise in analyzing the complicated actuarial and other issues that arise with respect to vesting and funding of plans. This expertise would constitute an invaluable asset in the administration of any new rules in those two areas. Also important is the fact that the tax law is largely self-enforcing. Unless the tax rules are met, plans cannot qualify for the special benefits set forth in Sections 401 through 404 of the Internal Revenue Code, or for the tax exemption of the plan funding mechanism, provided by Section 501(a) of the Code. This incentive, and the disastrous tax consequences of losing qualification, form an effective system of self-regulation without the need for a harsh and extensive enforcement bureauacracy, or new mechanisms for insurance and portability.

III. Status of Current Proposals

In March, 1962, President Kennedy appointed a Cabinet Committee on Corporate Pension Funds to study private employee retirement plans. In January, 1965, that Committee made its public report. 4/ The Committee focused on alleged abuses and deficiencies in pension plans and made recommendations with respect to vesting, funding, insurance, portability, and fiduciary standards. 5/ Subsequently, legislative proposals began to focus on these areas. Such legislation has been introduced in every Congress since 1967. Hearings have been held in one or both houses of the Congress in each subsequent year. Hearings turned up instances in which employees had terminated after long periods of service but before retirement, forfeiting benefits they had expected to receive. The hearings also produced specific cases in which plans had terminated without sufficient funds to pay accrued benefits. Many of these problems resulted from dishonesty and lack of fiduciary standards, and would be corrected by measures that would improve these standards.

In this Congress, a number of bills covering one or more of the areas of vesting, funding, insurance and portability are pending. The three major proposals, upon which this paper will focus, are:

(a) A bill proposed by the Administration, hereinafter referred to as the "Administration Bill." (S. 1631)

(b) Legislation proposed through your Committee, the Senate Committee on Finance, by Senator Bentsen, hereinafter referred to as the "Bentsen Bill." (S. 1179)

(c) Legislation proposed through the Senate Committee on Labor and Public Welfare, by Senators Williams and Javits, hereinafter referred to as the "Williams-Javits Bill." (S. 4)

The provisions of these bills are discussed in greater detail in subsequent sections of this statement. In addition, the Staff of the Joint Committee on Internal

Taxation has prepared an excellent summary of these Bills, which was issued on May 16, 1973. The Williams-Javits Bill with its strong provisions for vesting and funding, as well as for new insurance and portability programs, is now pending on the floor of the Senate, having been reported favorably by the Labor Committee. 6/

The Senate Finance Committee has been vitally interested in legislation in this field because its subject matter historically has been handled through the tax laws. Last year, while approving the disclosure and fiduciary responsibility portions of the Williams-Javits Bill (then S. 3598), this Committee did not report favorably on the vesting, funding, insurance and portability features, because of inadequate time to consider them, and because of the view of the Committee, that further consideration must be given to "balancing two conflicting considerations." Specifically, the report stated:

> "It is...important to recognize that as desirable as strengthening requirements for pension and profit-sharing plans may be, these plans are essentially voluntary insofar as employers are concerned with the result that stronger requirements tend to discourage <u>the widening of the use of private pension and profit-sharing plans</u>. Therefore, a careful balancing of these two conflicting considerations is needed in considering recommendations to strengthen provisions relating to private pension and profit-sharing plans. 7/ [Emphasis added.]

This balance between proposed new restrictions on private plans on the one hand, and the danger of discouraging the widening use of such plans on the other, has gained substantial force in the Administration and in Congress, because broader problems have been coming to the fore: Namely, the facts that a large proportion of employees is not covered by any plan, and that the level of benefits under many plans is too low.

For example, the Staff Summary prepared for your use points out that one-half of all employees in private, non-agricultural employment are still not covered by pension plans. 8/ Recent studies indicate that the portion who are not covered may be substantially larger than one-half. 9/ A House Labor Committee Staff Report, for example, has also noted that for current retirees the benefit levels of many plans are modest, and that provisions for widows benefits are widely inadequate. 10/ An appreciation of these facts has led the Administration and Senator Bentsen to suggest a program of further tax incentives to encourage increased coverage, particularly in the small business area, where profits often are small. At the same time, these facts must continue to impress upon your Committee, and all of the members of Congress, the need for moderation and restraint in the imposition of new standards upon a voluntary system that needs encouragement and expansion rather than restriction and additional burdens.

IV. The Growth of the Private System

During roughly the 10-year period since the Kennedy appointment of the Cabinet Committee, while legislation has been considered in an atmosphere of excessive criticism of the private pension system, that system has grown, and improved its performance on the two major points at issue; vesting and funding. Nothing is more important in the development of a perspective on this matter than the recognition of the fact that the situation is not static.

Between 1960 and 1970, the assets of private plans increased from $57.8 billion in 1961 to $138.2 billion in December 1970. 11/ Those assets are now estimated to exceed $150 billion. 12/ In the period between 1962 and 1969 there occurred what the Labor Department characterized as a "striking 29 percent increase" in the proportion of workers covered by plans with vesting provisions; plans with vesting or early retirement provisions covered 91 percent of all active participants in private retirement plans by 1969. 13/

The 1970 Study of Industrial Plans by Bankers Trust Company of New York contains some impressive statistics about improvements in vesting from the first half to the second half of the 1960s. The study covers 201 companies in 71 different industrial categories having between 200 and several hundred thousand employees.

Under the so-called "pattern plans" negotiated by international unions, the percentage of plans providing full vesting in 10 years increased from 10% in 1960-65 to 34% in 1965-70. Under "conventional" plans, the percentage with full vesting in 10 years increased from 12% to 21% in the same period. The worker who has attained age 40 with 15 years of service vested fully in 74% of the pattern plans, by the 1965-70 period. A worker meeting those requirements was fully vested in 48% of conventional plans by the 1965-70 period, up from 33% in the 1960-65 study. One hundred and three amendments to vesting provisions were made in the 1965-70 period in the covered plans considered in the study, and all but 6 liberalized vesting. 14/

Despite criticism of vesting provisions, the Social Security Bulletin for June 1971 (Volume 34, No. 6) shows that 58% of the individuals who were formerly employed, for wages or salary entitled to Social Security Payments at age 65, are also receiving second pensions from private pension plans. Private benefits paid in 1969 ($6.4 billion) were more than triple the 1960 figures ($1.8 billion). By 1971 that total had grown to $8.6 billion, and the average benefit payment was $1,730. In the same period, between 1960 and 1971, the number of beneficiaries almost tripled, from 1.8 million to 5.2 million. 15/

As to funding, a study of the subject for plans 10 years old or more, entitled "Inquiry Into The Status Of Funding Under Private Pension Plans In The United States" by Frank L. Griffin, Jr. (Vice President and Actuary, the Wyatt Company) and C. L. Trowbridge (Vice President and Chief Actuary, Bankers Life Company) was published in 1969 under the auspices of the Pension Research Council, Wharton School of Finance and Commerce, University of Pennsylvania. The Federal Government financed a substantial part of the cost of the study. The study found: A very high degree of benefit security has been achieved by the vast majority of plans included. Assets were sufficient on the average to cover approximately 95% of all accrued benefits under the plans with funding periods of 15 years or more. The ratio to vested benefits is even higher. The Staff Summary recently prepared for your Committee, and the Labor Committee statistics on which it is based, are somewhat less favorable, but even these statistics show very high levels of funding for plans in effect for reasonable periods of time. 16/ The evidence is overwhelming that sound financing has been the rule.

The real progress of the private system must create a healthy scepticism about whether new stringent Federal standards and new bureaucracies would help the situation or hurt it.

V. Vesting

A. Discussion of Proposals.

A discussion of vesting must center on specific proposals. Take the three major standards contained in the Administration Bill, the Bentsen Bill, and the Williams-Javits Bill: Under the Administration Bill, an employee must participate in a plan after the later of 3 years of service, or attainment of age 25. The Bill proposes a "Rule of 50" for vesting the interests of participants in qualified plans. Under this rule, an employee would have a vested right to 50% of his accrued benefits when the sum of his age and years of participation in the plan equals 50. This percentage would increase by 10% per year, to 100% over the 5 succeeding years.

The Bentsen Bill requires participation following the later of 1 year of service or attainment of age 30. A participant receives a 25% vested interest after 5 years of participation, plus 5% per year to 100% after 20 years.

The Williams-Javits Bill requires participation after the later of 1 year of service or age 25. The Bill requires vesting at the rate of 30% following 8 years of "covered service," plus 10% per year, to 100% after 15 years of such service.

The vesting schedule under the Administration Bill would be prospective (i.e., would only apply to benefits accruing after the effective date of the Act). The Bentsen Bill would apply retroactively to employees age 45 or over, and vesting under the Williams-Javits Bill would be wholly retroactive, applying to benefits accrued before the effective date of the Act.

B. Recommendations on Vesting.

A large segment of those who have considered the problem of vesting--including business, labor, the pension industry, and experts in the field--are now prepared to support reasonable vesting standards, despite the added burdens that such standards might impose, and the uncertain costs involved. One reason for this developing consensus is the need to establish Federal preemption and avoid the proliferation of varying State rules in this area. Of major importance in establishing those vesting rules, however, is a recognition that any legislation should set minimum standards to require improvement of plans that fall below a reasonable norm. In addition, the standards must be flexible.

1. Provide a Choice of Standards.

Employers should be permitted to choose among various approaches as long as the minimum level is provided. What is magic about any one of the approaches set forth in the pending bills; graduated vesting beginning after 5 years or 8 years; or vesting that reflects a combined age and service standard like the "Rule of 50"? As long as the plan's vesting schedule is designed to achieve substantially the same degree of vesting as the legislative standard, no change should be required in the plan.

The Williams-Javits Bill recognizes this problem, by granting the Government the power to waive the single statutory standard if the plan contains vesting provisions that are "as equitable as" the statute. This approach is helpful, but alternative standards should be set forth directly in the Act, with additional power for administrative waiver of these standards. The Williams-Javits Bill also contains a helpful special standard for thrift and savings plans, which contain vesting on a "class year" basis, i.e., separate vesting for each annual contribution by the employer. This standard would permit "class year" vesting schedules under which the employer contribution for a year would become vested after a period not exceeding 5 years. It is absolutely essential that flexibility of this kind be included in any final legislative product.

2. Provide Equitable Transitional Provisions.

It should be noted that the proposed bills do reflect a proper concern for easing the transitional period, setting reasonable effective dates, and granting appropriate waivers with respect to those dates. This concern must continue.

3. Define the Vested Benefit.

Again, the purpose of the legislation is to fix a statutory level of vesting in order to improve plans that are now below reasonable standards. I have suggested in the past that it would be appropriate to limit the statutorily imposed vesting standard to a benefit which when added to Social Security will equal 50% of final average salary up to the Social Security wage base. Even if such a limit is not imposed, vesting should not, as a matter of law, extend to pre-retirement death benefits, or require immediate payments upon early retirement. The legislation should clearly be defined, as it is in the Administration Bill, as a life annuity payable at age 65.

VI. Funding

A. The High Level of Funding.

Funding of pension plans is, of course, closely related to vesting. A vested benefit is of little use if it cannot be paid. But the problems of determining how to fund that benefit raise very serious issues of cost. What is involved is the manner of liquidating past service costs; i.e., costs for service rendered before a benefit is instituted.

As has already been indicated (at page 11) there is a very high degree of funding with respect to accrued benefits for plans in effect for reasonable periods of time. The funding level for vested accrued benefits is even better. Nonetheless, since the present tax rules require only that interest be paid on the past service liability so that it does not increase, it is apparent that any statutory requirement to liquidate that liability will constitute a change in the ground rules.

B. Current Proposals.

All three Bills continue the present requirements for funding future service benefits on a current basis. The Administration Bill would require that past service benefits be funded at the annual rate of 5% of the unfunded vested liability, plus interest on total unfunded past service liabilities. Under the Williams-Javits Bill, the unfunded liability for vested and unvested accrued liability for past service must be funded in equal payments over a period of 30 years from the effective date of the Act. Amendments to a plan that increase benefits substantially may be funded on a new 30-year schedule.

The Williams-Javits Bill also requires that any "experience deficiency" be funded over a period of not exceeding five years. An "experience deficiency" is any deficit occurring after the calculation of the initial unfunded liability when the plan is established or amended, except a deficit caused by a failure to contribute. For example, an adverse investment experience with respect to plan funds, or a major increase in compensation upon which benefits are based could cause such a deficiency.

The Bentsen Bill also requires funding all unfunded liabilities, vested or not vested, over 30 years. However, "experience deficiencies" are to be funded over the average working life of covered employees.

C. Recommendation on Funding.

Again, after thorough consideration of this issue over a substantial period of time, some consensus--although weaker than with respect to vesting--may be developing in favor of reasonable Federal standards for funding benefits under private pension plans. It is recommended that any standard adopted take the following into account:

The funding standards should focus on the aggregate period for funding. For example, a 40-year or 30-year period for funding of total benefits might be acceptable. If funding is applied only to vested benefits, the period could be even shorter--perhaps 25 years. It is important to recognize, however, that the Williams-Javits requirement to make up "experience deficiencies" in 5 years, would raise grave problems.

The plan's experience will not coincide precisely with actuarial assumptions at any particular point in time. The actuarial assumptions upon which employers fund their plans are based on the average anticipated experience over a long period of years. An increase in pay, for example, coupled with a decline in the stock market, could produce an "experience deficiency" of immense proportions in the short term. To consider irregular variations in experience as creating "deficiencies" or "surpluses" on a short-term basis is a total warping of the entire process of funding on the basis of long-range actuarial assumptions. The simple fact is that short-run variations from the assumed averages in no way indicate a real shortage or surplus in the funds. For these reasons, the provisions in the Williams-Javits Bill for funding experience deficiencies over five years must not be enacted. This important point must be preserved in any legislation that is adopted.

VII. Insurance

A. Current Proposals.

The search for pension benefit security has led to proposals for insuring the promised benefit against loss in the event the plan is terminated. An important distinction must be made between insurance proposals and proposals for vesting and funding. Plan administrators and the Government have extensive experience with the operation of vesting and funding standards. By contrast, there is absolutely no experience in the operation of an insurance program of the sort contemplated.

The Williams-Javits Bill illustrates many of the problems. It provides for an insurance program within the Labor Department. The program insures unfunded vested liabilities incurred both prior to and after the effective date of the Bill. The Bill insures investment losses, since the lack of full funding may result from the performance of plan investments, as well as from the fact that past service liability is funded over a 30-year period. The program would insure against the loss of such rights in the event of complete or "substantial termination," as determined by the Secretary of Labor.

The rights of the participants would be insured subject to the following limitations:

(a) The amount of insured benefit would be the lesser of (i) 50% of a participant's highest 5-year average monthly wage, or (ii) $500 per month.

(b) No insurance would be payable unless the plan (or an amendment, if applicable) had been in effect for more than three years.

(c) No insurance would be provided for shareholders owning 10% or more of the employer's stock.

Each plan in the Program must pay a uniform assessment covering administrative costs, plus an annual premium of .2% of the unfunded vested liability if (a) the plan was at least 75% funded during the five years preceding the effective date of the Act, or (b) the plan is a multi-employer plan. A single employer plan which was less than 75% funded would pay up to .4% of its unfunded vested liability incurred before the effective date of the Act, and up to .2% of its unfunded vested liabilities incurred after the effective date.

If the terminating employer is solvent, it would be liable to reimburse the Program for part or all of the amount disbursed to the participants. The liability is 100% of the unfunded vested liability, subject to a limitation of 50% of the employer's net worth. The employer's obligation to reimburse the fund becomes a lien on its property if it is not paid, and such lien follows the property into the hands of a successor. The lien is superior to everything except a Federal tax lien.

The insurance program under the Bentsen Bill is similar to that in the Williams-Javits Bill, with some important exceptions. For example, the program would not be administered by the Labor Department, but by a separate membership corporation entitled the "Pension Guarantee Corporation," with governmental, management, employee, and public representation on the Board of Directors. The guaranteed benefit would be the lesser of 50% of average wages or $1,000 per month, rather than $500 as in the Williams-Javits Bill. In general, insurance would apply only after the plan has been in effect for 5 years before the insured loss. No reimbursement obligation is proposed.

B. Objections to Insurance.

The implications of the insurance provisions of the proposed Bills reach far beyond those with respect to vesting and funding, and are substantially more objectionable. At this point, it is appropriate to recall the discussion early in this paper of the remarkable growth of private pension plans, and the need to expand coverage and benefits under those plans. At the same time, Congress must not lose sight of the fact, which was emphasized by your Committee last year, that employers do not have to establish any plan or set any prescribed level of benefits. What are being discussed, therefore, are voluntary programs. Against this background, the following objections must be considered:

First. The need is not established. Do the facts support the risks and burdens of an insurance program, and the potential disincentive against establishing and improving pension plans? The Labor and Treasury Departments have issued an Interim Report under the Study of Pension Plan Terminations, ordered by the President in December 1971. That Interim Report produced no evidence of a widespread problem. The Interim Report focused on the first seven months of 1972. Although the data covers only this short period, the findings essentially confirm earlier studies, such as the 1968 survey by the IRS and the Labor Department, which found that the exposure to loss of benefits through Plan termination is not very great:

The Staff Summary prepared for this Committee notes that for the seven-month period covered by the Interim Report, participants losing benefits constituted four one hundredths of one percent of workers covered by pension plans. 17/ Indeed, while your Summary noted that approximately 8,400 participants in 293 plans lost benefits, actually only 3,100 of these participants were retired or were fully vested before the plan termination, and only 2,700 would not be covered by a new plan, which might make those losses good. Again, this number is measured against the fact that, according to the Interim Report, there are now 23 million participants in private plans, and well over 5 million present beneficiaries. 18/

Your Summary points out that $20 million in accrued benefits were involved in terminations during this period. Indeed, of this relatively small amount, only about <u>half</u> represented fully vested benefits of long service employees of the sort that would be insured. 19/ Compare this amount to the fact that the reserves of private plans now exceed

$150 billion, and that $8.5 billion in benefits are now paid annually. 20/

There is every reason to expect that new funding standards would help to reduce the losses that are now being incurred. The issue, however, is whether the proposed remedy of a giant new Federally operated or regulated insurance program is the right solution when that program will affect virtually every pension plan in the country, will alter the private pension system as we know it, and will constitute a major deterrent to the establishment of new plans.

Many proponents of insurance admit that the problem is not widespread, and argue that for this very reason, a solution will not be expensive. Leaving aside the question of whether it is wise to support legislation *because* the need for it is relatively small, such arguments miss the essential point: The basic objection to insurance is not the initial premium cost, although in the case of new plans that cost could be very substantial indeed. The real concern is the potential for complete regulation of private retirement plans and the adverse effects that regulation would produce. The remaining portion of this section details these effects.

Second. A new bureaucracy would be needed. Federal standards would inevitably be prescribed for the valuation of plan assets, actuarial assumptions, definition of risk, computation of premium and--most insidious of all--rules regarding investment of plan assets. If the Federal Government is going to have a hand in insuring pension benefits to any degree, it stands to reason that the Federal Government is going to prescribe rules with respect to the underlying assets of the plan.

Third. The existence of an insurance pool to guarantee plan benefits would lead to pressure for increasing benefits beyond the financial capacity of an employer to pay for them. Benefit levels should be established in accordance with sound collective bargaining or management decisions free from the distortion which would be caused by a program funded by other employers to cover deficiencies.

Fourth. Such a proposal would encourage speculative investment of plan assets. The fact that a Federal pool would back up any losses would lead some plan administrators to take unwarranted risks in investments, leaving soundly managed plans to bail out the speculators. If their investment is successful, they will have reduced the cost of the plan to the employer. It their investment fails, the insurance pool will make up the loss. The cure for discouraging speculation would be worse than the disease. On the one hand, it would mean investment control by the Government. On the other hand, the danger of specualtion is one consideration that now leads

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some proponents of insurance to suggest that employers be required to reimburse plans for their insured losses.

Fifth. Proposals for reimbursement by employers of fund deficits are chilling indeed. Proponents of insurance programs say that it is necessary to place corporate assets behind the plan in order to protect against the kind of unreasonably risky results mentioned in Third and Fourth above. But here, again, the proposed cure would merely serve to magnify the basic problem of security for employees. After all, insurance becomes necessary only in cases in which an employer is in such financial difficulty that plan termination is required. Ironically, a liability to make up insured pension plan deficits out of corporate assets will add drastically to those very difficulties. It will reduce the company's access to credit at the time its very future is dependent on financial assistance. In short, it would tend to assure that the company could not continue in business. Some proposals also impose the employer's reimbursement liability as a lien on successors, hence, reducing the marketability of a troubled enterprise. In short, in addition to all of the other problems raised by insurance it would tend not to increase retirement security in the future, but to jeopardize the very jobs upon which that security depends by further adding to the problems of financially troubled employers.

Sixth. Most of the legislation recommended so far does not resemble true "insurance" in any sense of the word. The proposals simply assess sound plans to provide a pool for payment of losses of terminated plans.

C. Recommendation Against Insurance.

At the very least, such a program represents an effort to impose uniform Federal standards in an area that defies uniformity. Such a program would create a new bureaucracy, and would attempt to insure an almost indefinable risk, at a cost that is almost impossible to estimate. Particularly insidious is any proposal that will lead to governmental direction of plan investments, and to additional reimbursement liabilities upon employers and their successors.

VIII. Portability

The problem of portability derives from the fact that many employees work for a number of employers over their working lives. Present vesting practices do not envisage combining the vested benefits earned by an employee under one plan with those earned by him under a successive employer's plan. At present, an employee who reaches retirement with vested benefits under several plans will draw separate checks from each.

A. Current Proposals.

The Williams-Javits Bill contains a voluntary program, to be administered by the Labor Department, which would permit the transfer only of vested credits for employees who shift among employers who participate in the program.

The Bentsen Bill and the Administration Bill do not create a centralized agency. They would accomplish the same objective simply by allowing covered employees to transfer vested rights from one plan to another, free of tax, when they change jobs.

B. Recommendation Against Portability Involving a Centralized Agency.

The proposals for tax-free transfers among plans, such as those proposed by the Administration and Bentsen Bills, are highly desirable and should be adopted. More far-reaching programs should not be adopted. Surprisingly, the attacks against portability have come with equal force from representatives of Labor, Management, and Government.[21/] Some of these objections are:

(1) If a vested benefit is transferred out of a plan, it would be done on a fully funded basis. However, if the plan as a whole is not fully funded, the remaining participants will be adversely affected because the movement of money out of the plan would endanger its adequacy for the others.

(2) Each plan is different: benefit structures differ; the actuarial assumptions are not uniform; and the methods of valuing assets vary. If a pension credit based on one set of assumptions is transferred to a plan using a different set of assumptions, how are the benefits to be computed?

(3) In view of the difficulty in attempting to exchange pension credits between plans which have different benefit features or different actuarial assumptions, or different investment policies, a demand for portability ultimately will be a demand for standardized, identical fully-vested plans--thus, completely eliminating the flexibility to tailor plans to the individual needs and capabilities of the particular company and its workers. It would mean that the private pension system will be converted into another form of Social Security, with the Government setting regulations on actuarial assumptions, investment policies, and other features of the plan.

(4). A voluntary portability system, although infinitely preferable to a mandatory system, just can't perform. It is voluntary as to whether the employer will join the program. It is also voluntary as to whether the employee wishes to transfer his vested credits from one member to another. Even if he does, the successor employer also must be a member of the system. Thus, unless <u>all</u> employers join, and <u>all</u> transferred employees consent to the transfer of their vested credits to their new employer, we would have a patchwork system that would make the current practices seem absolutely streamlined.

(5) The real fact is, however, that a mere record-keeping system is by no means what portability would ultimately involve. Originally, it would be limited to vested benefits. However, sooner or later, centralization of what is actually vested in an employee when he leaves an employer would not be enough. Instead, such a mammoth superstructure would be used to transfer service credits when an employee leaves his employer without a vested benefit.

In other words, portability would not be simply a means of collecting whatever is vested. Rather it would be a means for insuring that a vested benefit accrues with respect to <u>all</u> of an employee's service and with <u>all</u> of his employers. The result would be one or both of two things; first, substantially reduced benefits and a significant disincentive to the adoption of new plans, or second, a major increase in cost levels.

IX. <u>Conclusion</u>

(1) Any Federally imposed vesting standards should provide flexibility, reasonable transitional provisions, and careful definition of the vested benefit. That standard should preempt the adoption of varying State rules on this subject.

(2) If Congress decides to establish funding guidelines, the overall period for such funding must be reason-

able. The experience deficiency provisions in the Williams-Javits Bill, and the 5% annual schedule in the Administration Bill should not be adopted. The Bentsen requirement for correction of deficiencies over the average remaining funding period of covered employees is preferable.

(3) No insurance program should be enacted. Such proposals raise markedly more serious problems than either vesting or funding. The cases they are designed to cure involve a very tiny fraction of 1% of the employees cover.. To set up a huge bureaucracy for so negligible a fraction of the pension universe would be foolhardy. Moreover, it would lead inevitably to standardization of actuarial assumptions and complete control of the investment of pension funds. No one has advocated these harsh results, yet without this control, the insurance risk could be varied at the will of the insured, and encourage unhealthy speculation.

(4) Portability is of questionable value and has been rejected by responsible officials of the Administration, Labor and Management. The desired result can be achieved by providing for tax-free transfer of vested amounts, as suggested by the Administration and the Bentsen Bills.

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Footnotes

1. I.R.C. Sec. 401(a)(3) and (4).

2. "Guides for Qualification of Pension, Profit-Sharing and Stock Bonus Plans." I.R.S. Pub. 778 (2-72), Part 5(c).

3. Income Tax Regs. Sec. 1.401-6(c).

4. "Public Policy and Private Pension Programs; A Report to the President on Private Employee Retirement Plans" (hereinafter referred to as "Cabinet Committee Report").

5. Cabinet Committee Report, pp. vi-xvi.

6. S. Report No. 93-127, 93d Cong., 1st Sess., Committee on Labor and Public Welfare.

7. S. Report No. 92-1224, 92d Cong., 2d Sess., Committee on Finance, p. 3.

8. "Summary of Proposals for Private Pension Plan Reform," prepared for use of the Committee on Finance by the Staff of the Joint Committee on Internal Revenue Taxation (hereinafter referred to as "Staff Summary"), p. 3.

9. "Social Security Bulletin," Social Security Administration, April 1973, p. 28.

10. "Interim Staff Report of Activities of the Pension Study Task Force of the General Subcommittee on Labor," Committee Print, 92d Cong., 2d Sess., p. 15 ff.

11. "Social Security Bulletin," Social Security Administration, April 1973, p. 32.

12. Ibid.

13. U.S. Department of Labor Press Release, February 13, 1970.

14. "1970 Study of Industrial Retirement Plans" (1970), Bankers Trust Company of New York, pp. 7-12.

15. "Social Security Bulletin," Social Security Administration, April 1973, p. 32.

16. Staff Summary, p. 5.

17. Id., p. 7.

18. Study of Pension Plan Terminations, 1972, Interim Report, Departments of Treasury and Labor (hereinafter referred to as "Interim Report"), pp. 30-33; "Social Security Bulletin," Social Security Administration, April 1973, p. 32.

19. Staff Summary, p. 7; Interim Report, pp. 30-33.

20. "Social Security Bulletin," Social Security Administration, April 1973, p. 32.

21. Hearings on S. 3598 (Williams-Javits Bill in 92nd Cong.), Senate Subcommittee on Labor, 92d Cong., 2d Sess.; Statement of James Hodgson, Secretary of Labor (p. 99); American Bankers Association (pp. 254-55); Leonard Woodcock, U.A.W. President (p. 790); National Association of Manufacturers (p. 813); I. W. Abel, United Steelworkers President (p. 1160).

Statement to the Finance Subcommittee
on Private Pension Plans
June 4, 1973

Edwin S. Cohen

The issues which the Subcommittee has asked the panel to discuss today require a delicate balancing of many competing considerations. Much thought and study has been devoted to them by many talented persons, not only in the Congress and the Administration but also in the private sector. The diversity of views that have been expressed is a reflection of the difficulty and complexity of the problems.

I should like to say, Mr. Chairman, that I do not pose as a specialist, or even as an expert, in the field of pension plans. Yet for some thirty-five years in the practice of the law and in government service, I have been engaged intermittently, and at times with some frequency, in the designing, drafting and operation of pension plans. From 1970 to 1972, I participated in the formulation and presentation of the Administration's pension plan proposals, though not in the supplemental recommendations made this year.

Before commenting on the specific issues, I would like to offer a few general observations:

1. In pension plans, as in so many other matters, we secure only what we pay for. A dollar paid into a pension plan will produce benefits which expert actuaries can estimate. To the extent that by law or regulation, or by design of the

plan itself, we require certain minimum standards of eligibility, vesting or other requirements, we must sacrifice other benefits, or else we must increase the cost of the plan. Increased costs for prescribed items mean decreased benefits to employees in other respects; or they mean increased costs to be borne by consumers in the price of goods and services, affecting the price level and our ability to compete in world markets; or they mean decreased return to investors, affecting the level of investment that is the source of job opportunities.

2. A most important feature of our private pension system is the flexibility that it permits to meet the special needs and desires of employers and employees in different industries and different businesses. Experience shows the need for increased minimum pension plan standards in a number of respects; but in fashioning the new law, if we were to set minimum standards too high, we would tend to limit the desirable flexibility of the private pension system because cost considerations would force reductions in benefits that would be beyond the required minimum.

In our discussion of what the law should require of pension plans, I suggest that we should avoid requiring by law what each of us might think reasonable for the average plan, but confine the law to what we think, at this time in our history, is a minimum standard of fairness for all employees. We should, I think, leave to negotiation more liberal provisions that may be traded off against increased current wages or other employee benefits, including other types of benefits in the pension plan itself. In particular, we should be cautious that we do not drive so high the costs of private pension plans as to impair the prospects of legislation for increased health insurance for employees.

3. In my experience, the pension field requires a great diversity of expertise on a variety of different subjects. It necessitates a merger, among other matters, of actuarial science, accounting, labor-management relations, tax law, trust law and labor law. When the respective experts have given their views, sometimes conflicting, generalists in the government and private sectors must ultimately absorb the analyses and make the ultimate decisions. The process is time consuming and unfortunately tedious.

In making the needed statutory changes, we should be careful that they are not so extensive that they exceed the capacity of government and private personnel to institute and administer the changes. Those that seem marginal or dubious could reasonably be deferred until the system has absorbed the essential changes and their effects can be weighed. To move too rapidly at one time on all fronts in the pension area could produce uncertainty and confusion that would be counter-productive.

With these general observations, I shall review briefly below the principal topics you have asked the panel to discuss.

1. Vesting requirements. Except with respect to certain plans created by self-employed persons, existing law contains no minimum vesting standards for pension plans other than such provision as may be necessary to prevent discrimination of officers, stockholders, and supervisory and highly compensated employees. While studies indicate that there has been a general upgrading of vesting provisions in recent years, I understand that only about 32 percent of participants in corporate pension plans now have vested benefits. Many of these participants without vesting are young persons without substantial periods of service with their employer; large numbers of these employees will later qualify for vested benefits, either with their present or a future employer. But there is a large proportion of older workers who do not have vested rights and who, because they have fewer years remaining until retirement, are especially deserving of increased vesting protection. If older workers terminate employment, they will have less opportunity than younger persons to accumulate pension rights with other employers.

Accordingly, it has impressed me as especially disturbing to find that only some 40 percent of participants over the age of 40 have vested benefits, and only some 46 percent of those over age 60 have vested benefits.

My study of various minimum vesting standards that have been suggested for legislation has led me to the conclusion that the so-called "Rule of 50," proposed by the Administration, is the most satisfactory. Under this proposal, when the sum of an employee's age and years of participation in the plan equals 50, his benefits must be at least 50% vested. In the five years following, his vested portion must increase by at least 10% per year, until by the end of the five years he must achieve 100 percent vesting.

The Rule of 50 would, I understand, increase the total number of plan participants with vested rights from 32 percent to 61 percent. But an even more important effect would be that with respect to participants age 40 and over, it would increase the percentage with vested benefits from 40 percent to 92 percent. The rule when fully effective would essentially solve this problem of the older worker, and it is his problem that I think is more serious than that of the younger worker.

The data recently presented by the Administration indicates that enactment of the Rule of 50 as a minimum standard would increase overall pension plan costs by 2.4% in contributions, or 0.15% of covered payroll, or three-fourths of a cent per hour in wages. For those plans which now provide no vesting prior to retirement, the estimate is that the Rule of 50 would increase plan costs by 7.6% in contributions or 0.38% of covered payroll or 1.86¢ per hour.

I am persuaded to favor this proposal among those that have been advanced because the data indicates that in general it involves less additional cost than the others, but particularly because it concentrates protection on the older workers who, as I say, seem to me the most deserving of vesting protection.

Other vesting proposals that are most costly will reduce the level of retirement income that can be provided by the same funds for those who remain employed until they retire, and do not give special consideration to the greater vesting needs of the older workers.

The vesting proposals in S. 4 and S. 1179 are based exclusively upon years of participation by the employee, and give no consideration whatsoever to his age in the relative priority of vesting among employees. Age is a factor in determining eligibility for plan participation under all the pending bills, and it is generally used in determining normal retirement date and early retirement privileges and for other purposes. I do not think it wise for the legislation to rule out age entirely as a proper consideration in a vesting standard minimum for pension plans.

It is true that the Rule of 50 gives, in effect, an equal weight to age and years of participation in determining vesting. It would, of course, be possible to vary the formula, or to set a schedule based on age brackets, that would give greater weight to years of participation than to age. But to say that age may not be taken into account under any circumstances in the minimum standard of vesting seems to me inadvisable.

The objection that I understand has most frequently been made to the Rule of 50 is that it would tend to discourage the hiring of older workers by employers who have fixed benefit plans. In order to provide a fixed pension benefit at a normal retirement age of 65, the annual cost for a new older employee will be substantially higher than it would be for a younger employee. But this is true, regardless of the vesting provisions. It is particularly true because the older worker has a shorter period remaining before retirement, and hence the contribution will remain in the pension fund accumulating compound interest for a lesser period of time. The Rule of 50 would add relatively little to the annual cost of the pension of the older worker, either proportionately or in absolute amounts, and it is my view that it would not be a material factor in the choice between the hiring of an older or a younger employee.

For these reasons, if called upon to choose between the various vesting standards which have been suggested, I would be inclined to select the Rule of 50. On the other hand, I could not say that the vesting standards proposed in S. 4 or S. 1179 would not provide reasonable protection for employees

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as a group. I suggested earlier that the effort in the new legislation should be towards enactment of minimum standards of fairness rather than to legislate a single standard which we might consider appropriate, and that flexibility is important in the private pension system. Accordingly, it might well be desirable for the new law to accept as a minimum vesting rule any one of these three standards, or indeed any other standard which the federal administrative authority might approve as being equivalent in purpose and effect.

I think it fair to say that there is merit in all of the standards that have been proposed, and we have been debating for many months merely their relative merit. If the Congress selects a single standard, many plans now in existence that meet one of the other standards may have to change. There may, indeed, not be a sufficiently compelling reason to force such a change or to require a single vesting standard, particularly as to existing plans. It would be a major step forward if the law required plans to meet any one of the standards pending before you.

Another aspect of the vesting matter is the extent to which the legislative requirement should apply to benefits accrued prior to the effective date of the new law. The costs of granting vesting for previously accrued benefits as well as future accruals would be significantly higher than if the new requirement were made applicable only to future accruals.

Benefits under existing plans have been provided on cost assumptions that did not take into account the new vesting rules that would be enacted, and the additional cost of providing vesting retroactively for previously accrued benefits would have serious financial effects in some cases. This would be true to a large extent even if retroactivity were confined to employees over age 45, as in S. 1179. Accordingly, I am inclined to favor the Administration recommendation that service prior to the effective date of the law be counted with future service in determining when the employee satisfies the vesting requirements, but that the vesting apply only to benefits accruing in the future.

Still another significant question is the choice of a minimum standard of eligibility for participation in the plan. The proposals for corporate pension plans vary from one year of service and age 25 in S. 4, to one year of service and age 30 in S. 1179, and three years of service and age 30 in the Administration proposal (S. 1631). Because of greater turnover among young workers and the costs of including in the plan short-term employees who terminate employment, as well as my inclination to apply contributions to the benefit of older workers, I would favor the Administration proposal as an acceptable minimum for all types of plans. To some extent, the choice is affected by the vesting standard to be adopted.

Funding. All three of the pending bills would require an increase in the funding of deferred benefit pension plans by the employer. It is extremely difficult to weigh the effects of the several proposals upon the many different types of existing private pension plans. Once again, I would urge measured care in prescribing minimum annual contribution, so that the first step taken is not so large as to endanger the survivial of existing plans or discourage unduly the creation of new plans to cover the half of the work force that unfortunately today have no private pension plans. Once the first step has been taken and its results have been weighed, further legislation can be enacted with greater insight and foresight to increase the funding requirement.

Some of the proposals would require funding of past service costs, both vested and unvested. I would be inclined, at least in the first stage, to confine the funding requirement to the vested benefits, as does the Administration proposal. This would be somewhat comparable also to the accounting provisions in this respect in the Accounting Principles Board Opinion No. 8.

The Accounting Principles Board Opinion permits employers to choose between two alternative minimum standards of funding for the purpose of their financial statements. This suggests the possibility, in view of the apparent differences of view as to the most desirable single standard, that the new law stipulate not one, but two (or perhaps several) minimum funding standards, so that satisfying any of the minima would be considered acceptable. Such a solution might be especially useful with respect to existing plans that were established without knowledge of the new rules.

The requirements in S. 4 for funding "experience deficiencies" over a five-year period could produce substantial cost fluctuations and other serious difficulties and I believe require modification or should be deleted.

Portability. The issue of portability means many different things to many different people. If adequate minimum standards for vesting and funding are provided, much of the significance of portability would be eliminated, save perhaps as a convenience. The great divergence of the terms and degree of funding of private plans makes many types of portability impractical, and indeed could make it unfair to remaining employees when the plan is not fully funded.

The system that would be established under S. 4 is entirely voluntary in the sense that it would operate only if a pension plan applied for membership and if an employee participant terminating employment with vested benefits chose to use the system. It would at least establish a permissible system for those employers and employees who jointly wish to avail themselves of it. But, as I indicate, caution is needed that the withdrawal rights of a departing employee, or a group of them, do not damage the rights of remaining employees, especially when the plan is not yet fully funded. And care should also be taken that the time and attention of qualified personnel is not so consumed in the establishment and operation of this limited type of voluntary portability system as to impair institution of the other important innovations contained in the legislation.

A system could be devised with simplicity that would permit the Social Security Administration to serve as a vehicle to keep former employees and pension plan managers in contact with each other if they have changed address since the employee terminated employment. Together with adequate vesting and funding, much of the portability problem would be solved in this fashion.

The Administration's proposed amendment of the tax law to permit a "roll-over" of pension distributions received on termination of employment before retirement (i.e., impose no tax upon the distribution if the amount is promptly redeposited in another qualified plan) seems a desirable provision. Coupled with the other proposed amendment, which I would also favor, to permit an employee to establish his own qualified plan to which he can contribute when he is not covered by an adequate employer-created plan, the two provisions should prove especially helpful to persons changing employment.

<u>Termination insurance</u> seems a desirable objective but the difficulties involved are formidable. There are

numerous questions as to the method of fixing and allocating the insurance premiums required. But I would express special concern about the provisions relating to recovery by the insurance program from employers for any insurance benefits paid by the program to the beneficiaries of a terminated plan. The Committee report accompanying S. 4 states (p. 26):

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

Referring then to a concern for the "potentially enormous liabilities" that might be imposed on some employers if they were required to assume fully responsibility, the report then goes on to state:

> "Accordingly, the Committee endorsed a formula of employer liability which requires the employer to reimburse the plan termination insurance program for the total amount of insurance paid, but in no event greater than 50% of employer's net worth at time of plan termination."

Section 405 of S. 4 thus provides for recovery from the employer of "100 per centum of the terminated plan's unfunded vested liabilities" on the date of plan termination, limited to "50 per centum of the net worth of such employer." It creates a lien for such liability in favor of the United States on all property of the employer, except as against a lien for federal tax liabilities.

The issue of employer liability goes to the heart of the issue of feasibility of the insurance program, and deserves most careful consideration in view of the "potentially enormous liabilities" that may be involved. One question is whether those potential liabilities, up to half the employer's net worth, would have to be reflected as liabilities, or reserves would have to be provided, on the financial statement of the employer. This is essentially a question for certified public accountants, but I think it important to obtain a firm answer. There are many provisions in bonds, loan agreements, preferred stocks and important contracts which depend upon maintenance of certain prescribed ratios of assets and liabilities, or upon other tests in which the amount of liabilities are important, even if they are limited to half the net worth. If these large liabilities must be reflected or provided for, significant defaults could occur. But even if confined to a footnote explanation in the balance sheet, they could affect seriously both creditors and investors, depending upon judgment as to the degree of possibility of plan termination before funding is completed.

These problems are especially important because the liability would extend, as I read the bill, to vested benefits for service rendered before, as well as after, the effective date of the law.

The importance of the limitation of liability to half of "net worth" of the employer would indicate need for a definition of that term. While it is an expression frequently used in a general connotation, it gives rise to doubt as to its meaning in particular situations. It is more an accounting than a legal concept, but in the bill it would be used to define a legal liability.

The liability would be imposed upon a "successor in interest" to the employer, but that term is not defined. It might, for example, apply to a person who purchases for full value a part of the business of the employer (even though the employer's liability is limited to half its net worth). In that event it would affect the opportunity to realize on the value of the employer's assets, for persons would hesitate or decline to buy them.

Section 404(d) of S. 4 provides that "any person or persons who terminate a plan insured under this title, with intent to avoid or circumvent the purposes of this Act*** shall be personally liable for any losses incurred by the Pension Benefit Insurance Fund in connection with such plan termination." Section 3(11) of the bill defines the term "person" to include an individual. Thus, apparently an individual who is involved in the termination of the plan would be personally liable in potentially enormous amounts under a vague test as to whether he did so "with intent to avoid or circumvent the purposes" of the new law. It would be difficult to know which individuals would be considered to have "terminated" the plan, or to describe precisely the purposes of the Act that must not be circumvented by termination. The vagueness of the test and the magnitude of the potential liability seem to require further reflection.

The difficulties in these problems of termination insurance are not merely technical matters. However the technical aspects might be resolved, there remains the fundamental dilemma in termination insurance that substantial employer liability for vested benefits would be grave in amount and consequence, and yet insurance without such liability would furnish opportunity for abuse in the designing of plans and speculative investment of plan assets. To date I have seen no satisfactory resolution of that dilemma, though we should all continue to strive for a solution.

REFORMING PRIVATE PENSIONS

Testimony of Frank Cummings before a hearing of the
Committee on Finance
United States Senate
Monday, June 4, 1973

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References

SUMMARY OF TESTIMONY

This testimony is in five parts, outlined in greater
ii-iii detail in the attached Table of Contents.

1-6 Part I is a general introduction, reviewing the principal complaints against the private pension system, the causes of those complaints (late vesting, weak funding, ineffective fiduciary standards) and explaining why retirement planning as an individual-by-individual basis has failed.

Part II is a review of the current state of the pension
7-10 industry -- the statistical material on size, types of plans, benefit
11-20 levels, and forfeitures; the current legal framework and its weaknesses;
20-23 and the problems of the "professionals" who now work in the field
(lawyers, union leaders, corporate executives, accountants and actuaries etc.)

Part III is a review of the current legislative proposals.
24-29 It includes, first, an analysis of "who should enforce pension
standards" and supports Labor Department enforcement; and it examines,
29-59 next, the various bills, concluding that S.4 is the preferable
measure as to vesting, funding, portability, reinsurance, fiduciary
standards, and enforcement. It also reviews the alternative proposals,
33-40 concluding that S.1179 and S.1631 are too weak to be effective, while
58-59 alternative "radical" proposals are both unrealistic and undesireable.

60-61 Part IV reviews possible costs, and concludes that the cost of any of the pending bills would be reasonably manageable.

61-64 And Part V concludes that while S.4 is not a perfect measure, its enactment is needed, but that it should be supplemented by tax measures (originating in the House) to allow individual tax-deferred retirement accounts.

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REFORMING PRIVATE PENSIONS

Testimony of Frank Cummings* before a hearing of the

Committee on Finance

United States Senate

Monday, June 4, 1973

I. Introduction

A. Who Forfeits, and Why

1. Late Vesting

Too few participants who work "under" private pension plans actually get a pension; and too many who work long years -- 10, 20, 25 or more years -- get nothing.

They get nothing, not because of evil men or bad motives, but because of badly designed plans, many of which fail to provide reasonably attainable vested non-forfeitable interests, or even provide no vesting at all even after long years of work, unless the employee actually reaches retirement age in the employ of the same employer. And Americans no longer typically do that -- instead, they are mobile, moving from job to job, and forfeiting pension after pension along the way.

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That is the vesting side of the controversy.

2. Weak Funding

But there is also a funding side: There are too many plans in which the pension "promise" -- even if vested -- is so woefully underfunded that, if the employing enterprise should terminate, it might as well be no promise at all.

3. Some Sample Complaints

Here are some of the cases which keep turning up with increasing frequency. These are seven case histories quoted verbatim from a recent Report of the Senate Labor Subcommittee (S. Rep. No. 92-634, 92d Cong., 2d Sess. 87-88 (1972)):

"Case Number 1 -- Underfunding

> "A large steel mill engaged in the production of iron and steel materials maintains a pension plan with total assets of $19 1/2 million. However, its accrued vested liabilities are in excess of $66 million. In the event of plan termination, under its current financial structure, less than 1/3 of accrued vested benefits could be paid through available pension assets. This plan started in 1950, and the employer is funding only current benefits costs.

"Case Number 2 -- Vesting

> "This employer is a nation-wide department store whose pension plan contains no vesting provisions prior to qualifying for early retirement. Early retirement requirements consist of age 55 and 15 years of continuous service, or age 50 and 20 years continuous service. Under the terms of plan eligibility, any worker of the thousands employed who would terminate employment prior to attaining age 50 will forfeit all benefits, not withstanding the number of years of employment.

"Case Number 3 -- Vesting

"An aircraft manufacturer in the Midwest established a pension plan providing for vesting of benefits at a combination of age plus service to total 60. This results in a new employee, who begins to work at age 20, to be required to work 20 years to receive vesting at age 40. Conversely, an employee hired at age 50 would only be required to work 5 years to vest at age 55. This vesting formula is a deterrent to employers to hire older people because of the shorter vesting period required.

"Case Number 4 -- Portability

"Mr. X began employment for a Midwest meat-packing company in 1927, at one of the employer's two plants in the same city. During World War II, he was sent to work in the other plant in the city because of the need to fulfill government contracts. He remained there until 1965 when the plant closed. The employer would not permit him to transfer back to the former plant as a regular employee, but only as a casual and intermittent laborer at the former plant. When the plant was closed, Mr. X was paid a total of $231.55 for his accrued pension benefits, despite 38 years of continuous employment with the same employer. Since he was reemployed in his old plant as a casual laborer, he was not eligible for any pension benefits after 1965. In 1970, he was dismissed because he was overage at 65. He did not recieve any pension benefits. In sum, this employee was dismissed at age 66 after 43 years of continuous employment with the same employer and with no benefits to him except $231.55, paid to him in 1965. Had he been permitted to carry his pension benefits and credits from both plants with the same employer, which were located a few streets apart, Mr. X would have been eligible for a pension.

"Case Number 5 -- Vesting

"The pension plan of a large cotton-milling company provides for vesting at age 55 with 20 yaars of service. Although the accrued vested liabilities were less than $5 million, the pension fund contains over $30 million in assets. This obvious overfunding is attributable to the stringent vesting provisions which drastically reduced eligibility for benefits.

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"Case Number 6 -- Overfunding

"This pension plan belongs to one of the largest retail food chains in the United States. As of December 31, 1969, the pension plan assets' value totaled $118 million, and total accrued vested benefits were $60 million. The plan's vesting requirement is age 50 and 20 years of service.

"Case Number 7 -- Vesting

"A large hardware manufacturer purchased a manufacturing plant in 1958 at Trenton, New Jersey. At the time of purchase, the plant maintained a pension plan to which the employer was contributing 18 1/2¢ per hour. The plan contained vesting provisions. The new owners negotiated a new contract with the union representing the workers and eliminating the vesting and fixed funding by the employer. In 1970, the company relocated the plant to the Midwest to cut production costs. None of the 333 employees were allowed to go to the new plant, despite the fact that some of them were within a few months of retirement eligibility. Of the employees, 8 were over 65 years of age and were permitted to retire. The remaining workers were dismissed and received no pension benefits whatsoever. Of these, 175 employees were over 40 years of age; 32 of them had in excess of 30 years of service. With respect to fund assets existing at the time of acquisition in 1958, the employer has consistently claimed that all rights by union and employees wree relinquished when the contract was renegotiated in 1958."

As you can see, these cases deal primarily with vesting and funding (and I include the subject of "reinsurance" as an aspect of any realistic solution to the funding problem).

4. Fiduciary Standards

The other side of the pension controversy has to do with fiduciary standards and the prohibition of unethical conduct and conflicts of interest in the handling of pension funds -- of which the most notable recent case history involved the deposit of vast pension reserves of The United Mine Workers Welfare and Retirement Fund in a non-interest bearing account in a bank owned by The United Mine Workers of America. Blankenship v. Boyle, 329 F. Supp. 1089 (D.D.C. 1971), 337 F. Supp. 296 (D.D.C. 1972).

B. Why Individual Retirement Planning Has Failed

Faced with these and certain other difficulties in obtaining real security from the private pension plan system, many employees have sought solutions on an individual basis, and on occasion, devices have been found which are of some help, but here the strictures of the Internal Revenue Code are sometimes less of a help than a hindrance.

A pension on an individual basis faces these alternatives: (1) if an employee contributes his own money, he loses the tax advantages of Sections 401-404 of the Code; (2) if the employer pays for it, it will most often be discriminatory in violation of Section 401, and so those advantages are likewise lost; (3) as of this year, the IRS is taking one more step to demolish an individual's option to do his own pension planning, by charging the individual with immediate constructive receipt of any compensation he elects to defer by using a "salary reduction agreement" providing for employer contributions to a pension plan in the same amount as the salary reduction (Proposed Treas, Reg., 37 Fed. Reg. 25938 (12-6-72)); (4) which still leaves the employee the option of a simple deferred compensation agreement, without tax deferral for the employee unless the plan is either unvested (which risks forfeiture) or unfunded (which risks non-payment) (Rev. Rul. 60-31, 1960-1, Cum. Bull. 174).

C. What is Needed: Comprehensive Re-Thinking of Our Approach to the System

So what is needed is some new, comprehensive, and humane re-thinking of our over-all approach to private pensions.

Doubtless there will be some cost in any new approach, but we already pay a substantial cost whenever we let a worker retire without adequate resources -- a cost in welfare and related programs, in loss of purchasing power in a significant segment of our economy, and in loss of morale and productivity. Surely there is some cost in pension reform, but it needs to be evaluated against the benefits to be gained as a result. And the cost need not be high.

But if we are going to pay any cost for reform of the private pension system, we ought to make sure we get our money's worth.

Before getting into the details of legislation, however, we ought to examine, first, where we are now: The dimensions of the pension industry (current statistical material), the current legal framework in which the industry operates, and the techniques and dynamics of the "professionals" in the field.

II. The Current State of Things

A. Current Statistical Material

1. The Dimensions of the Pension Industry

The size of private pension reserves, in the aggregate, is now in excess of $166 billion (SEC, Statistical Bulletin, Vol. 32, No. 8, 4/4/73), with another $148 billion in public pension funds. The growth of the private total has been in the neighborhood of 10% per year.

As far as I can tell, this represents the largest aggregate of essentially unregulated capital in the Nation.

2. Types of Plans

The Senate Labor Subcommittee completed, last year, a "Statistical Analysis of Major Characteristics of Private Pension Plans" (republished in S. Rep. No. 92-1150, 92d Cong., 2d Sess. 73-148 (1972)). The study itself was based on answers to a 32-page questionnaire sent out to a carefully-designed cross-section of the industry (a total of 1500 plans were surveyed).

The major conclusions were these (*id.* at 115-16):

> "1. Approximately one-third of the pension plans studied had both a minimum age and service requirement for participation in a pension plan. An additional 25 percent had a minimum service requirement only, and approximately 35 percent of the plans had no age or service requirements for eligibiltiy to participate.
>
> "2. The most common normal retirement age was 65 (occuring in almost 90 percent of the plans). In over half of these plans, a service requirement also existed, in a few cases as much as 30 years. In the

case of over one-fourth of all participants, attainment of age 65 and at least 15 years of service was required for a normal retirement benefit.

"3. About 13 percent of the plans studied did not provide for any vesting at all. For those plans which had vesting provisions expressed as a combination of age and service, the combinations most frequently encountered were in the range of from 40 to 44 years of age with from 15 to 19 years of service. However, more stringent vesting formulas were also encountered; 8 percent of the plans had both an age and a service vesting qualification which required at least age 50 and 20 years of service for a vesting right. In the plans where only a service requirement was established for vesting, over one-fourth of these plans required more than 15 years of service to qualify. Among pension plans containing vesting provisions, over 55 percent had only a service requirement.

"4. Over 30 percent of private pension plans were utilizing a deferred graded form of vesting, by which a certain percentage of a participant's accrued retirement benefit is vested initially, and the percentage increases periodically as the employee completes additional service. Profit-sharing plans utilize this type of vesting more frequently (over three fourths of all such plans).

"5. Information regarding the assets and liabilities of pension plans was reported inconsistently and incompletely by a sizable number of pension plans. However, of those plans which did report appropriately, over 45 percent had a ratio of assets (valued at market) to total liabilities of over 75 percent, and three-fourths of the plans had a ratio of market assets (valued at market) to vested liabilities of over 75 percent. While this finding established that a majority of pension funds are generally well-funded, the responses also revealed a significant minority of plans which were substantially underfunded. Over 10 percent of the plans reporting disclosed a ratio of assets (valued at market) to vested liabilities of 50 percent or less.

"6. Only 40 percent of private pension plans had formal restrictions pertaining to investment of pension plans assets, <u>and less than one-half of all plans required annual audits by an independent licensed or certified public accountant</u>.

"7. <u>Over 35 percent of the pension plans studied, covering a similar number of participants, did not provide an opportunity for participants to request a hearing on claims</u>; less than 30 percent of all plans provided for a written denial of such claims; and only 30 percent of all plans provided for review procedures with respect to denial of claims." (Emphasis added).

3. <u>Benefit Levels</u>

The Senate Labor Subcommittee also extracted, from the answers to the same questionnaires, benefit level data which was published in its 1971-72 Interim Report, S. Rep. No. 92-634, 92d Cong., 2d Sess. 26 (1972). The key result was the disclosure that the median normal retirement benefit level under private plans is $99 per month.

4. <u>Forfeitures</u>

What becomes of individual participants, working (and moving) within this system? No really comprehensive study has yet been made -- and perhaps none can be made, because of the difficulty inherent in tracing individuals as they move from plan to plan. The Senate Labor Subcommittee <u>did</u> do a limited study of 87 plans -- 51 with no vesting or late vesting, and 36 with vesting after 10 years of service or less. The Report contains the following summary (S. Rep. No. 92-634, 92d Cong., 2d Sess. 129 (1972)):

"1. Four percent of all participants since 1950 in the 51 no vesting or later vesting plans have received normal, early or deferred retirement benefits; eight percent of all participants in the 36 earlier vesting plans have received such benefits.

"2. Five percent of all active participants since 1950 who left the plans have received normal early or deferred retirement benefits; 16 percent of all active participants since 1950 who left the 36 plans have received such benefits.

"3. 70 percent of all participants since 1950 in the 51 plans have forfeited without qualifying for benefits; 38 percent in the 36 plans have forfeited without qualifying for benefits.

"4. 92 percent of all active participants since 1950 who left the 51 plans forfeited without qualifying for benefits; 73 percent of all active participants since 1950 who left the 36 plans forfeited without qualifying for benefits.

"5. Of the total forfeitures in the 51 plans since 1950, 85 percent were participants with five years service or less; of total forfeitures in the 36 plans since 1950, 80 percent were participants with five years service or less.

"6. In the 51 plans, for every two participants who has received a normal, early or deferred retirement benefit since 1950, one participant forfeited with more than 15 years service, for every one participatnt who received a benefit, one participant with more than ten years service forfeited, three participants with more than five years service forfeited, and 16 participants with more than five years service or less forfeited.

"7. In the 36 plans, for every one participant with more than 15 years service who forfeited since 1950, 24 participants received a normal, early or deferred retirement benefits; for every participant with more than 10 years service who forfeited, seven participants received such benefits; for every participant with more than five years service who forfeited, one participant received such a benefit; for every participant who received such a benefit, four employees with five years service or less forfeited." (Emphasis added).

We cannot say, of course, whether the employees who forfeited under these plans got other jobs with other employers under other plans and eventually earned a pension elsewhere. We only know they worked a long time for nothing under these plans.

B. Current Legal Requirements

1. Internal Revenue Code

(a) General Rules

The Code now grants three significant tax advantages to a "qualified" pension plan which, together, constitute a gigantic "bonus" from our tax laws.

The employer gets a tax deduction for his contributions to the plan (Int. Rev. Code §404).

The employee, for whose benefit the contributions are made, gets a tax deferral -- that is, he is not taxable on the money contributed on his behalf until a much later time when he retires (a time when his tax bracket is much lower) (Int. Rev. Code §§402, 403, 72).

And the trust fund itself may accrue income, dividends, and capital gains, without any tax whatever on its own income or growth. (Int. Rev. Code §§401, 501(a)).

All this the government grants to private pension plans because these plans serve a socially useful purpose.

But do they? Some do, but many do not, and they need not in order to remain "qualified" under the Code. For, absent special circumstances, the Code requires no vesting at all until the employee actually retires, and no funding beyond payment of current service costs plus an amount equal to "interest" on unfunded past service liabilities (he need never fund those liabilities at all) (Rev. Rul. 69-421, Part 6(d)). And so the irony is not only that the Studebaker plan could pay only 15 percent of vested benefits to employees when its South Bend plant shut down in 1964 (Federal Reinsurance of Private Pension Plans, Hearings Before the Committee on Finance, United States Senate, on S. 1575, 89th Cong., 2d Sess. 50 (1966)), but also that the very same thing -- and worse -- can still happen, without loss of tax qualifications, and no matter how "mature" the plan is. For Studebaker's plan had some vesting (10 years and age 40) (ibid.), and funding of past service liabilities over 30 years (id. at 112), but the plan was only 14 years old (ibid.).

Studebaker's plan had vesting and funding, but it need not have so provided, under the Code as it existed then, nor as the Code exists today. A plan may be 100 years old and still not have funded past service costs; it may provide no vesting at all; and in either event -- or both -- the plan may still remain "qualified" under the Code.

(b) "Prohibited Transactions"

The Code does touch upon fiduciary standards, in the sense that it contains a list of prohibited transactions (§503). But this does not prohibit the trust, for example, from investing in the securiteis of the employer, which results in subjecting the plan to the same risks as if it were <u>unfunded</u> -- if the employer collapses, so does the plan.

And even if the Code <u>did</u> prohibit effectively all self-dealing, what would be the remedy? If a beneficiary complains and the plan is disqualified, the <u>fund</u> loses its tax exemption, and the employee loses even more of his retirement security.

2. <u>The Welfare and Pension Plans Disclosure Act</u>

Setting aside the bonding requirements (which were added to the Act after its original passage and have no real effect on "who gets what"), this law creates a whole set of disclosure requirements, and a whole agency full of files, but under it, a plan can do just about anything, so long as it is "disclosed" -- and believe it or not we have had Congressional investigations which turned up all sorts of misappropriations of pension funds, which were, in fact, "disclosed" in the sense that the actions of the trustees were duly filed under this act. Indeed, even when the Labor Department discovers inadequate disclosure in a case such as this, the remedy is simply to ask the plan to amend its disclosure forms to add additional information -- which in turn rarely does the individual pension participant any good. See <u>Hearings Before the Permanent Investigations Subcommittee, U.S. Senate Committee on Government Operation, on Diversion of Union Welfare-Pension Funds of Allied Trades Council and Teamsters Local 815</u>, 89th Cong. 1st Sess. 482 (1965) ; S. Rep. No. 1348, 89th Cong. 2d Sess. 27 (1965).

3. Securities Acts

Some time ago, there was a developing interest in pension plans, particularly profit-sharing retirement plans, insofar as they created "securities" under various securities acts. SEC v. Variable Annuity Life Ins. Co., 79 Sup. Ct. 618, 359 U.S. 65 (1959), reversing 257 F.2d 201 (2d Cir. 1958); Prudential Ins. Co. v. SEC, 326 F.2d 383 (3d Cir. 1964), cert. denied, 377, U.S. 953 (1964). But the ineresst in pension plans has been somewhat diminished, with two exceptions, by later amendments. See Institutional Investor Study, Report of the Securities and Exchange Commission, Summary Volume, H. Doc. No. 92-64, Part 8, at 69-70 (1971).

Outside the area of registration requirements of the Securities Acts, there has been some litigation concerning the application fo fiduciary standards in these laws, and that controversy continues. See Local 734 Bakery Drivers Pension Fund Trust v. Continental Illinois National Bank, Dkt. No. 72 Civ 2551 (N.D. Ill. 1972); and the general discussion in Panel Discussion, Conflicts of Interest and the Regulation of Securities, 28 Business Lawyer 545 (1973).

4. National Labor Relations Act

Again, we have peripheral regulation, but not really affecting the central issues under discussion here. Pensions are a mandatory bargaining issue (Inland Steel Co. v. NLRB, 170 F.2d 247 (7th Cir. 1948), cert. denied on this issue, 336 U.S. 960 (1949), affirmed on other grounds sub nom. Communications Assn. v. Douds, 339 U.S. 382 (1950)), although recently the benefit levels of those already retired turned out to be only a permissive bargaining subject (Chemical Workers v. Pittsburgh Plate Glass Co., 30 L. Ed. 2d 341, 78 L.R.R.M. 2974 (1971))--a distinction which I suspect will turn out to be more technical than real.

We also know that a plan cannot, on its face, limit participation on the basis of union membership of lack of it (Kroger Co., 164 N.L.R.B. 362 (1967), enforced in part, 401 F.2d 682 (6th Cir. 1968), cert. denied, 395 U.S. 904 (1969)), but such a restriction is again more apparent than real, as one generally can limit plans to "hourly paid", etc., and get the same result.

The real discrimination -- against all but those employees who manage to stay with one employer until retirement age-- is not covered by the act.

5. Other Statutory Provisions

One could go on and on, reviewing what law there is on this subject. There is section 302(c) of the Labor-Management Relations Act, which exerts some limits on fiduciary practices, insofar as they fall within the context of "bribery" of a union official. There is title VII of the Civil Rights Act, which has generated considerable litigation lately concerning sex discrimination in the benefit structure of benefit plans (different retirement ages, discrimination as to maternity benefits in the context of disability insurance, etc.).

And there are innumerable State laws, and the State common law in every State, which have some influence in this area.

But I have yet to find any law now on the books which has any really substantial impact on "Who gets what, and when," i.e., on vesting, funding, reinsurance and fiduciary standards, so we are breaking new ground--at least in the United States, although there are other nations which are far ahead of us (see, e.g., the Ontario Pension Benefits Act, 1965, c. 96, as amended).

6. Weaknesses in Ordinary Trust Law, and Enforcement Problems

Ordinary trust law ordinarily applies only to trustees in the classic sense, and key decisions in pension administration are often made by persons not holding the legal status of trustee. Pension administrators need not be trustees. Investment discretion may be vested in labor-management committees who are not trustees in the legal sense. All sorts of other persons -- investment counselors, actuaries, accountants, employers, unions, and others -- may effectively be making fiduciary decisions while not occupying the legal position of a fiduciary.

The lack of comprehensiveness in ordinary trust law once led a Senate Subcommittee to conclude that "the application of well-established doctrines of trust law to the field of employee benefit trust funds is a most difficult task". S. Rep. No. 1734, 84th Cong. 1st Sess. (1956). The American Bar Association's Report of the

Committee on Trust Administration and Accounting, Exculpatory Clauses/Their Legal Significance, Vol. I, No. 4, Real Prop. Prob. & Trust 530 (Winter 1966), observed: "Under the typical employee benefit trust agreement the beneficiaries (the employee participants) have very insubstantial enforceable rights." Thus, it has been possible for courts to hold that the exercise of rights reserved by the employer with respect to a pension plan con- clusive "in the absence of fraud or such gross mistakes as imply bad faith or a failure to exercise an honest judgment", and evidence to sustain the burden of showing such fraud, bad faith, or mistake "must be more than a mere preponderance, it must be overwhelming." Menke v. Thompson, 140 F.2d 786, 791 (8th Cir. 1944).

Even the rights a pension participant has tend to be illusory when he tries to use legal processes which might seem, at a first glance, to be available to him. See generally Elliott, Federal Fiduciary Standards for Welfare and Pension Plans 366 (1968) (published by the Association of Life Insurance Counsel); Levin, Proposals to Eliminate Inequitable Loss of Pension Benefits, 15 Villanova L. Rev. 527, 566 (1970).

Consider the average problem faced by a lawyer when a potential client walks through his door and says either "they owe me a pension," or "they are misusing the money in the pension fund".

The lawyer asks, "Who are they?" How many employees know the corporate name of the employer, the exact name and location of the trust and trustees, the location of the bank holding the money, the name of the insurance company through which the plan is funded, if it is funded that way, the identity and addresses of the unions involved, including the international and local unions and their officers, and those of the officers who have been designated as trustees? How many employees even know the real name of the plan or the trust or its technical terms?

But assume, as you have no right to assume in most cases, that the employee knows the answers to all those questions. Then the legal problems have just begun. Whose law applies? The bank is in one state, the corporation in another state, the employees in several other states, the union in another state, and the contract may not specify a choice of law.

But even if you could decide (probably after costly litigation) which law applies, what court would have jurisdiction to serve process in all those states, and bring in all the necessary parties? I know of none -- and that includes any federal court, which, of course, can serve process only within the state in which it sits. Fed. R. Civ. P.4(f).

But assume further, as you have no right to assume in most cases, that you could find a court able to serve process on all the necessary parties. What would you sue for?

If you are suing not for a pension but to stop misuse of the money by the trustees, the recovery goes not to the plaintiff employee but back into the fund. It is essentially a derivative action, from which the plaintiff recovers nothing but increased security for his pension expectancy.

If, on the other hand, the employee is suing for a pension, the recovery is the discounted value of one pension (unless the plaintiff can put together a rare class action, or unless a union is financing the lawsuit at substantial expense to itself). Now consider the cost of litigating those very complex questions of law which I have just discussed. How much is the lawyer going to charge for this lawsuit? In most cases, even if the lawyer takes only a minimal fee for this elaborate lawsuit, his fee will necessarily far exceed the amount of recovery (the discounted value of one pension). And to compound the problem, keep in mind that most misdeeds by pension administrators are brought to light in lawsuits by employees who have yet to vest, so that even if you win, your client doesn't get the recovery, and he may not even get a pension either.

Of course, there are class actions, which work on occasion. There are lawsuits financed by persons other than individual pension participants (e.g., a union, by resort to its treasury), and so forth. But most pension claims, if they are for benefits, are unpromising. And if the action is simply to rectify a breach of fiduciary standards not involving an actual denial of benefits, the recovery, after all, goes back into the fund, not to the individual participant, and so the plaintiff is financing a lawsuit somewhat in the public interest -- at considerable

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(usually prohibitive) expense to himself. And if the plaintiff is already retired, he may not live long enough to enjoy the benefits of his recovery.

In short, private lawsuits, under existing law, do not provide a meaningful remedy for the employee in most pension cases. What is needed is a national law, with a national agency to enforce it, which will get this whole matter out of the area of ordinary, garden variety, litigation, which simply does not work.

C. The Weaknesses Inherent in the Current Dynamics of Private Pension Planning; The "Professionals"

A wide variety of professionals are at work in the private pension system. The key men are lawyers, accountants, actuaries, union leaders, corporate financial executives, and professional pension planners and consultants (who are often actuaries or lawyers -- but need not be).

1. Lawyers

First, a few words about the lawyers -- and what I have to say here is not absolute, and leaves room for many notable exceptions (hopefully including myself). Most lawyers working regularly in this feeld are tax lawyers, because the principal "rules of the game" are tax rules. The client is the contributing corporation, and the object is to secure tax qualification. That is certainly a legitimate and necessary objective, but, as noted above, it has little to do with the beneficiary's income security.

The rest of the legal profession -- labor lawyers included -- seems to have abdicated in favor of the tax lawyers. That, in my view, is a tragedy, because too often (though not always) no one is representing the interests of the beneficiaries at the planning stage.

2. Union Leaders and Corporate Executives

Our system of collective bargaining assumes -- correctly, I believe, in most cases -- that the union protects the employee's interests, and that the employer protects corporate financial interests, leading eventually to some viable compromise. Only rarely do we look behind the union's demands to see if individual concerns are being properly represented, e.g., Vaca v. Sipes, 386 U.S. 171 (1967), and bargaining is not even required as to pension rights of those already retired. Compare Allied Chemical Workers v. Pittsburgh Plate Glass Co., 404 U.S. 157 (1971), with Inland Steel Co. v. NLRB, 170 F.2d 247 (7th Cir. 1948), cert. denied on this issue, 336 U.S. 960 (1949), affirmed on other grounds sub. nom. Communications Assn. v. Douds, 339 U.S. 382 (1950).

But a union, after all, is supposed to be a democratic organization, and, if it is, most often it is dominated by its younger members who have little concern with pensions. Thus, many pension plans have developed with benefit levels which increase, year after year, but with vesting so deferred that only a few members ever actually receive those benefits. There are notable exceptions, of course -- for example, the Steelworkers and Auto

Workers. Those exceptions tend to occur in industries where strong seniority systems protect the older workers from layoff and permit the median age of the work force to rise. But, too often, unions (particularly those representing low wage workers) are either unable or unwilling to press for earlier vesting. See, e.g., Testimony of Andrew Biemiller for the AFL-CIO, in Hearings Before the Subcommittee on Labor, Committee on Labor and Public Welfare, on S.3598, 92d Cong., 2d Sess., part 3, at 1114 (1972).

Employers, on the other hand, cannot reasonably be expected to fight hard for a reallocation of dollars already spent. Once the bargaining process has settled on a dollar figure -- total increased labor cost to reach a settlement -- if the union wants X% of it in wages and Y% in pensions, no employer in his right mind would take a strike to force an increase in Y and a corresponding decrease in X, if the total is the same!

In short, the dynamics of collective bargaining simply break down -- not always, but often -- when it comes to pensions.

3. Actuaries and Accountants

Accountants audit, actuaries project. An accountant can tell you what your assets and liabilities are now, but a pension plan needs to know whether, 20 years from now, the plan will be solvent, after projecting over that period of time such variables as interest rates, contribution rates, employee turnover, life expectancy, and other factors which make up the lexicon of "actuarial assumptions."

The irony is that the accountants are licensed, but the actuaries -- who are the key men -- are not licensed in any state. Most actuaries are highly skilled professionals, but they need not be, and at least a significant number of them are nothing more than salesmen, who package and sell pension plans, tailored to suit the needs of "buyers" who want a decent benefit level at minimum cost (an easily obtainable objective if the plan is set up so that almost everyone forfeits his credits). Again, not all of the "salesmen" function this way -- but a substantial number do.

In sum, the professionals at work in this system give us no real assurance that the legitimate pension expectations of long-service workers will be realized.

What is needed is a new law.

III. The Proposals

Last year there were dozens of pension reform bills, but none passed, though one -- S.3598 (renumbered as S.4 this year) -- was favorably reported from the Senate Labor and Public Welfare Committee.

This year, we have roughly the same array of bills, and S.4 is once again on the Senate Floor Calendar.

Before getting into the vesting-funding rules, etc., however, some consideration should be given to the jurisdictional issues.

A. Who Should Enforce Pension Standards, and by What Medium?

The IRS collects taxes; it does not (cannot, will not) enforce private rights.

The Labor Department enforces employee rights; it does not (cannot, will not) collect taxes.

You may ask, if you wish, "Who should enforce pension standards?" But the question, standing alone, is meaningless, and no one is seriously asking that question.

No one has suggested that S.4 be amended by striking out the term "Secretary of Labor" and substituting, instead, the term "the Secretary of the Treasury". Indeed, if that were the only proposal, the Secretary of the Treasury would be horrified by the prospect, and he would be completely unequipped to deal with administration of S.4 -- just as unequipped as the Secretary of Labor would be if he were suddenly given responsibility for administering Sections 401-404 of the Internal Revenue Code.

The real question is not "Who should enforce?", but rather, "What kind of a law do you want?" Once you decide what kind of a law you want, the enforcement question almost answers itself.

The Internal Revenue Code asserts a hypothetical imperative: "If you want these tax benefits, then you must qualify under these standards."

S.4, on the other hand, asserts a catagorical imperative: "You must conform to these standards" (no "if's" about it).

B. How the IRS "Enforces" the Code

The IRS is not essentially an investigating and enforcing agency. The initiative ordinarily comes from the taxpayer. He claims the deduction, and the IRS then reviews his claim.

The controversy is essentially between (a) the person who files a tax return, and (b) the IRS who reviews it. Indeed, if a pension participant were to go to the IRS and complain, and if he were permitted to review these tax returns (as he may not be), he would only be cutting his own throat. The most he could accomplish would be to disqualify the plan, and if he did so, he would be, in effect, reducing his own pension.

I was counsel for the Labor Subcommittee just last year in hearings involving underfunding of a pension plan of employees of American Zinc Company. The attorney for those employees testified as follows:

> "MR. CUMMINGS: As far as you know, this is a tax-qualifed pension plan, is that correct?
>
> MISS HILLMANN: As far as we know, yes. We have been so informed by the company.
>
> MR. CUMMINGS: I take it you are aware that, at least under the present interpretations of the Internal Revenue Code, a continuing plan has the obligation to fund no less than current service costs, plus an amount equal to interest on past unfunded credits, and I take it that what you are saying is that they have not even complied with the requirements of the IRS; is that right?
>
> MISS HILLMANN: The information we have now leads us to believe so, yes.
>
> MR. CUMMINGS: Do you have any information which would suggest that the IRS ever took any notice of the fact that this plan was not complying with the code?

MISS HILLMANN: We have no such information, no.

MR. CUMMINGS: And I take it, finally, just to let the record show, that if you had known that it wasn't complying with the code and sought to enforce the code, you would have only cut the throats of your own members by disqualifying the plan?

MISS HILLMANN: Right. We are in a real bind here.

MR. CUMMINGS: So those requirements put you in a vicious circle, I take it, where the only remedy you get is to take money away from your own members?

MISS HILLMANN: That's correct."

(Private Welfare and Pension Plan Study, 1972, Hearings Before the Subcommittee on Labor, Committee on Labor and Public Welfare, United States Senate, 92d Cong. 2d Sess., Part 1, at 378 (1972)).

C. Enforcement of "Requirements" (as Distinguished from Tax Qualifications)

As to the catagorical imperatives of S.4, on the other hand, the enforcement structure is set up so as to invite pension participants to come in and tell the enforcement agency when the requirements of law are not being met. And if they are not met, the government is given the power, not to tax and penalize the fund (and thereby to deprive the participants of retirement reserves), but rather to bring an action in a federal district court to compel compliance with law -- payment of adequate contributions, proper conduct of the fund's affairs, and proper payment of benefits.

This is essentially a function of preserving the rights of workers -- a traditional function of the Labor Department. This is the same function which the Labor Department performs in so many other areas. A worker who is not paid time and a half for overtime goes to the Labor Department, and the Labor Department has the power to compel that payment. We do not ask the worker to go to the IRS and insist that a tax penalty be imposed upon the employer for failure to pay minimum wage or time-and-a-half for overtime. There would be no reason for him to do that. The tax penalty, moreover, is least effective when it is most needed. The time when a company stops paying the usual pension contributions is when the company is losing money, has no profits, and doesn't need the tax deduction. So it defers payment of current service costs; it defers payment of interest on past unfunded liabilities; it defers payment of proper amortization of those liabilities. It takes no deduction. Why should the IRS complain? There is no deduction for the IRS to disqualify! But that is the very time when enforcement of funding standards is most necessary. That is the very time when the fund is in danger, the plan is in danger, and pensions are in danger.

D. A Choice of Agencies

Returning to my original hypothesis, would it make sense to give the IRS, or the Treasury Department, jurisdiction to enforce affirmatively the categorical imperatives in S.4? Who would do the enforcing? Certainly not the IRS. Certainly not the Treasury Department. They have no staff at all equipped to do that.

By this I do not mean to say that the Labor Department is necessarily the best agency for such enforcement. Far from it. After all, we are dealing with sophisticated financial institutions -- banks, insurance companies, brokers, actuaries, accountants, and so on. None of these insitutions has any familiarity whatever with the Labor Department, and the Labor Department has even less familiarity with them.

Ideally, we ought to have an independent commission, like the SEC, which could consolidate the necessary expertise in all of these fields, as well as in the employee benefit and labor fields. That was the idea behind the original Javits bill (S.2 in the 92d Congress), which I drafted and which later formed the basis for S.4. Another advantage of that commission, I believe, is that it would make it possible to consolidate in a single agency all regulation of pension plans. The authority to determine tax qualification could be vested there; all the fiduciary standards, disclosure, vesting, funding, portability, re-insurance, and so forth could be vested there. And a fund, which is going to be subject to all of this additional regulation, could at least get the benefit of "one-stop service".

Proliferating bureaucracy is a horror, but consolidation is worthwhile. If the pension thrust branch of the IRS really has such extensive expertise, there is no reason whatever why the personnel of that branch could not be transferred, en masse, to such a commission. If there is expertise in the Bureau of the Labor Department which now administers the Disclosure Act, the personnel of that branch could be transferred there, to such a Commission. With a corps of personnel like that, drawn from the IRS, the Labor Department, and perhaps also from the SEC, the Justice Department and from State Agencies preempted by federal law, I would doubt very much that any great additional bureaucracy would be needed.

Such a consolidation, however, would become much more awkward in any of the cabinet branches. It is most unlikely that jurisdiction to make tax determinations could properly be vested in the Labor Department. And it is even more unlikely that jurisdiction affirmatively to protect employee rights could be vested (or would be accepted) by the IRS. These agencies are already too specialized in a particular approach.

But the commission idea was around for years, and no one seemed interested. I must say, I see no evidence of increasing interest in it now. That being the case, one is forced to choose between the options that remain -- the Labor Department, or the Treasury Department.

Choosing between thse options, one really has to abandon the notion that there will ever be decent consolidation of enforcement and one-stop service. The taxing power will remain in the IRS. Only the Labor Department is equipped to deal with employee complaints as such, and to try to satisfy them.

The upshot of all this is that, while the Labor Department is far, far from an ideal enforcement agency, once Congress accepts the principle that a pension reform law should give employees direct rights, enforceable by them, and enforceable in their behalf by the government, only the Labor Department, of existing agencies, is equipped to undertake that task.

E. What should the Standards Be?

1. Vesting

(a) Earning a Pension When you Are Young -- The Arithmetic of Vested Pension Accruals

One ought not to confuse the arithmetic of vesting with the computation of the amount vested.

It is true that an employee who enters participation in a plan at the age of 48 under the so-called "rule of 50" will be 50% vested in a year -- his age (49) plus his credited service (1) will equal 50 -- and five years after that he will be 100% vested (an additional 3-year pre-participation period of exclusion is allowed by S.1631, and is not factored into this calculation).

But vested in what? One hundred percent vested in 6 years of accruals. But the odds suggest that he will have no accruals for the 23 years he worked from the age of 25 until age 48 when he joined this, presumably his last, employer.

Three hypothetical cases should demonstrate the difference. In each of these cases I use the following assumptions:

a. Uniform contribution rate of $1500 per year (the maximum allowed, for example, under the "individual retirement account" proposed by the Curtis bill, S.1631).

b. An arbitrary rate of return fixed at 6% simple interest, compounded annually (obviously, it could be higher, but the higher rate would doubtless be discounted by inflation.)

c. A level payout, of principal plus accumulated interest on the principal balance, for 15 years -- from age 65 through 80, or the balance to a survivor (See. Treas. Reg. §1.72-9, Table 1).

Case A: Contributions from age 25 through 65 (40 years), fully vested. The total reserve accumulated during the 40 years would be $232,142. Payout in retirement for 15 years: $23,901 per year.

<u>Case B</u>: Full vesting from ages 48 through 65 (17 years). The total accumulation would be $42,319. Payout in retirement for 15 years: $4,357 per year.

<u>Case C</u>: The employee hired at 48 who vested 50% in 1 year (age 49), and 100% in five more years (age 54), and then lost his job. His 100% vesting in 6 years of accruals generates a reserve of $10,462 at age 54. By age 65 (10 years later) it would grow to $18,736. Payout in retirement for 15 years: $1,929 per year.

True, all three pensions were "100 percent vested." But the employee whose accruals began at the age of 25 found himself with a pension sufficient to provide a very comfortable life in retirement. The one whose accruals, though fully vested, began at the age of 48, and continued steady accruals until age 65, nevertheless found himself on the edge of poverty. And the one who vested only in the 6 years' accruals from ages 48 to 54 found himself with a "100% vested" pension of $1929 per year -- only $37.10 per week.

Vesting is fundamental, because an unvested pension accrual is often worthless. <u>But vesting 100% of a pittance still produces a pittance</u>.

The two keys to decent pensions are early vesting <u>and</u> lifetime accruals. Like a safety deposit box in a bank vault -- without both keys, it just won't work.

(b) The Vesting Standards In S.4

S.4 now pending on the Senate floor calendar (Calendar No. 119, S. Rep. No. 93-127) has 53 co-sponsors, and so I will take it up first.*

S.4 would require that every pension plan (with minor exceptions -- plans with less than 25 participants, public plans, Keogh plans) provide for vesting (non-forfeitability) on a deferred graduated schedule: after eight years of service, 30% vesting; and 10 percent more vesting each year until 100% vesting is required after fifteen years of service (§202).

Alternative vesting schedules found by the Secretary of Labor to provide comparable benefits for most participants are permitted, nevertheless (§202(c)), and one might assume that a flat 10-year vesting standard might qualify in some circumstances.

The computation of credited years is as fundamental as the vesting schedule itself. The bill provides that the plan may not require covered service to be "continuous" except that three of the first eight years may be required to be continuous -- otherwise, the bill is really based on "aggregate service" rather than the more common and grossly unfair concept of the "continuous

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*For parlimentary purposes, it is worth noting that an identical bill, H.R.976, has been introduced in the House and has been referred to the Committee on Education and Labor. Neither bill contains any tax features. And S.4 could not constitutionally contain them, as the Constitution (Article I, Section 7, Clause 1) provides that tax measures must originate in the House. Short of purely tax features, the vesting provisions of S.4, like the other provisions of S.4, are the most comprehensive of the pending bills.

service" now used in most pension plans. Frankly, I see no logical basis even for the three year continuous service requirement now appearing in Section 202(b)(1) of S.4.

The bill also prohibits a preparticipation period beyond the age of 25. Again, I see no basis for allowing any preparticipation period, but certainly this preparticipation period is minimal (§202(b)(2)).

The bill provides vesting with respect to covered service "both before and after the effective date of the title" (§202(a)). The objective is laudible, and the cost, according to the actuarial study accompanying the bill, is relatively low. If it can, constitutionally, be done, it ought to be done, in my judgment, but I do not believe sufficient attention has yet been paid to the constitutional question of what may amount to a retroactive amendment of contractual obligations.

(c) The Vesting Standards in the Administration Bill, S.1631 -- the "Rule of 50"

Of course, the most fundamental difference between S.1631 and S.4 is that the vesting provisions of S.1631 are not requirements at all, but only conditions of tax qualification (a weakness discussed in greater detail above).

Setting aside the enforcement mechanism, however, and addressing oneself solely to substantive requirements of the Rule of 50, they are simply, that the employee must be 50% vested when his age and credited service equal 50, and must vest the balance over the succeeding five years.

S.1631 permits a greater preparticipation period than S.4. One need not count any service before the age of 30, nor need one count the first three years of service in any event (Section 2(a)(2)), and one need not count any service within five years of retirement age. The Rule of 50 system, therefore, is really a system to provide a means whereby an older man can earn a pension while he is an older man. For the reasons supplied in greater detail above, it puts all the burden on the last employer, and provides a minimal pension at best.

It has been argued by the supporters of the bill that the Rule of 50 would not be an incentive for age discrimination, but it seems self-evident to me that the cost of hiring a man in his late 30's or early 40's must be higher than the cost of hiring a man in his 20's under this bill, because a 20-year old would vest nothing for 15 years, and a 45-year old would vest 50% in three or four years.

(d) The Vesting Standard in the Bentsen Bill -- S.1179

This bill, like S.1631, is primarily a tax bill, and suffers from all of the weaknesses inherent in that enforcement device, explained more fully above.

The vesting schedule begins earlier than any other bill (25% in five years) but ends later than any other bill (100% only after 20 years).

Obviously, the fashioning of the vesting schedule is a matter which is subject to fair legislative judgment, and Congress will have to reach that judgment. Five years to begin vesting strikes me as a most reasonable schedule; 20 years to complete vesting strikes me as grossly unreasonable in this day and age.

In any event, the bill permits exclusion of all years under age 30, which again is unwise.

One ought also to note that this vesting schedule uses the retroactivity feature in last year's version of S.4 (applicable to prior service only for employees over the age of 45). As mentioned above, there may be a constitutional questions inherent in <u>any</u> legislation with respect to service before the effective date of the new law. But if application to prior service <u>is</u> constitutional, then I see no reason to limit the application ot this feature to persons over the age of 45 -- why not go the whole way, if the cost is manageable?

2. <u>Funding</u>

Funding schedules raise several associated questions which ought to be discussed in a general way before getting into the arithmetic.

(a) <u>General Standards for Evaluating Funding Requirements</u>

First, if one is talking about a system incorporating federal plan termination insurance ("reinsurance"), then the funding is there primarily to protect the reinsurance fund rather than the participant -- and that is the case under S.4 and the other bills providing for reinsurance.

If, on the other hand, funding is provided without associated reinsurance, then the funding schedule is a direct correlary of the vesting schedule -- it determines "who gets what". In that sense, any funding schedule which does not distinguish the various "layers" of benefits is really a distribution scheme.

For example, in the Studebaker case so familiar to this Committee, the plan was fifteen years old, and was on a 30-year funding schedule. Why, then, did employees with over 40 years of fully vested service forfeit 85 percent of their vested benefits? The reason was that each time benefits were increased, the additional unfunded past service liability was simply added on to the original past serv' :e liability, increasing the total, as a lump sum. When the plan was finally terminated, the priorities of distribution resulted in most of the reserve going to retirees and practically none of it being given to unretired vested employees, even those with over 40 years of service. In short, that funding system had inherent in it a judgment as to the priorities of distribution of a fund not sufficient to pay all vested benefits.

In my judgment, it would be fairer to treat each substantial increase in benefits involving an increase in past unfunded service liabilities as a separate plan, for funding purposes. Thus, an initial grant of benefits, required to be funded over a stated number of years (25, for example), would be fully funded after the expiration of 25 years regardless of how many other benefit increases took place in the meantime. Each separate benefit grant would likewise be funded over a new period of 25 years beginning on the date of grant. In the event of termination of the plan, an employee who was fully vested in any "layer" of benefits would be entitled to payment of the amount of money which had been funded for that layer -- and if it were fully funded, he would be entitled to it all, even though subsequent layers of benefits were not fully funded. That strikes me as a more equitable method of distribution of a funded plan than the current system which gives all the funds to the retirees, and only secondary rights to vestees, regardless of how old the vestees are and how many years of service they have earned.

The second imporaant factor to note with respect to funding scehdules is that, if one approaches the funding requirement on a declining balance basis, it will take an infinite period of time to complete the schedule. A requirement that a percentage of past unfunded service liabilities be funded each year will produce a declining contribution each year, as the unfunded balance declines, subject, however, to increases resulting from benefit increases.

With those standards in mind, one can approach the various funding schedules in the bill pending before the Congress and make some evaluation.

(b) The S.4 Funding Requirements

S.4 provides a 30-year funding schedule (Section 210(b)). That is, the contributing employer must pay all normal service costs currently, plus an annual payment sufficient to amortize past unfunded liabilities over a period of thirty years.

The bill also approaches the problem of "layers" of unfunded liabilities by providing that an increase in benefits resulting in a substantial increase of unfunded liabilities of the plan shall be treated as a "new plan" both for purposes of the funding schedule and for purposes of the reinsurance provisions of the bill (Section 210(b)(2)(B)).

(c) The S.1631 Funding Requirements

S.1631, the Administration bill, now provides for funding, but includes no correlative reinsurance provision. Accordingly, one must treat this funding provision not only as a means of obtaining security, but as part of the set of priorities for the distribution of benefits. In that sense, the funding schedule is barely adequate.

It does provide that, for pusposes of tax qualification, contributions each year must consist of the normal cost of the plan plus 5 percent of the unfunded liabilities for benefits. This is the "declining balance" approach to pension funding, which would allow an infinite period of time for full funding. No approach to the various "layers" of benefits is involved, and thus, inevitably, when the plan shuts down, the employees who are vested but not retired will experience some forfeiture.

One ought to keep in mind that the Studebaker plan was funded on a better schedule than that required by S.1631, and yet employees who were 100% vested and had accrued over 40 years of service forfeited 85% of those vested benefits.

(d) The S.1179 Funding Requirement

The Bentsen bill, S.1179, includes both reinsurance and funding, and so one can approach funding here as a means of protecting the reinsurance fund, rather than as the last resort of the participant himself. The 30 year funding schedule in the bill (Section 323) is adequate.

A weakness in the Bensen approach to "experience deficiencies", however, is that this bill permits a plan to fund such deficiencies over the working life of the employee, whereas S.4 requires a five-year make-up of such deficiencies.

(e) A Comment on "Experience Deficiencies"

Experience deficiencies result, primarily, from actuarial mistakes or bad investment experience. The rapid 5-year make-up schedule in S.4 functions not only as protection for the fund in the event of termination but also as a deterrent to risky plan management practices and unreasonable actuarial practices. What is the penalty, after all, for an investment gone bad, or for unreasonably optimistic actuarial assumptions? If the investments go bad or the actuarial assumptions prove preposterous, the resulting deficiency may be amortized, under S.1179, over quite a long period of time -- and under the Administration bill (S.6131) over an even longer period of time (an infinite period of time) at 5% of the balance per year.

Under the S.4 approach, on the other hand, a soundly financed plan based on conservative actuarial assumptions is permitted to take a full 30 years funding, but any experience deficiencies resulting from erroneous actuarial assumptions or arising from investments gone bad must be made up in five years. S.4 attempts to control actuarial assumptions, and its fiduciary standards attempt to control investment practices. But, after all, the real way to control both those practices is to impose a penalty for gambling, and the heart of that penalty is in the experience deficiency provisions.

Accordingly, I would think the experience deficiency provisions of S.4 are preferable to those in S.1179, and obviously preferable to the complete absence of such provisions in S.1631.

(f) Current Funding Practices

Most sound pension funds are funded substantially as well already. See Accounting Principles Board Opinion No. 8, of the American Institute of Certified Public Accountants (eff. 1/1/67). The minimum standard set by the Internal Revenue Code, however, permits a somewhat weaker funding schedule -- current service costs plus a sum equal to "interest" on unfunded past service costs. The difference, I believe, will not be a substantial cost problem, and, in consequence, there has been relatively little controversy concerning funding requirements.

3. "Portability"

While S.4 has a title called "portability," it is important to distinguish between the provisions of this title and the more widely heralded popular notion of "portability" which appears in so many political speeches.

More often than not, the word "portability" has been used as a shorthand designation for whatever solution is being currently advocated for the problem of pension forfeiture arising from labor mobility. As the rhetorical theory goes, people move from job to job, and their pensions ought to be "portable" so that they can take them along as they move.

That is not really what the portability title in S.4 is all about. On the contrary, the problem of forfeiture is dealt with primarily in the vesting title, or else it is not dealt with at all.

What, then, does this portability title do? It creates a clearinghouse for the transfer of the current discounted value of pension credits which are already vested. (§301(a)). An employee leaving a job having earned a vested pension credit would be entitled to transfer the current (discounted) value of that vested pension credit into a central federal clearinghouse, where he could leave it until retirement, or else, when he takes another job with a pension plan tied into the clearinghouse, that credit could be transfered to the new job, into the new plan, to purchase whatever credits that much money is worth. (§§302-05).

It is voluntary, under the bill, in two senses: first, the plan (that is, the company and/or the union) need not tie into the clearinghouse at all (§301(a)). Second, even if the plan ties into the clearinghouse, the individual participant in the plan is given the option of transferring credits through the clearinghouse, or simply leaving his vested credits in the plan where he earned them. (§§302, 305).

In short, I see no sensible way to object to this portability scheme as written. If you don't like it -- forget it. It is not a panacea; it is a convenience.

4. <u>Reinsurance</u>

S.4 would create a federal pension plan termination insurance program to guarantee payment of vested pension rights, whether or not the fund has sufficient assets to pay them.

The classic problem, to which tiis title is addressed, is the famous (or infamous) Studebaker shutdown in South Bend, Indiana a decade ago in which long-service Studebaker employees with vested pension rights forfeited 85 cents on the dollar of their pension entitlements.

But that sort of collapse, while rare in <u>percentage</u> terms,is a disaster in human terms. A study published just this year by the U.S. Treasury and Labor Departments ("Study of Pension Plan Terminations", Interim Report, February 1973) discloses that in the first seven months of 1972, 8,400 persons lost benefits as a result of plan terminations -- benefits worth $20 million, or $2,400 per claimant . True, this represented only 0.04 percent of participants -- but it's 8,400 disasters nonetheless. And the low percentage merely proves the feasibility of reinsuring against these disasters.

While the bill undertakes to reinsure pension rights earned both after and before the effective date of the act (§401), the amount of reinsurance is limited to 50% of an employee's highest monthly wage, or $500 a month, whichever is less (§402(b)).

The bill sets the initial premium rate at 0.2% of unfunded vested liabilities (§403(b)(2)), subject to revision later on the basis of experience. (§403(b)(3)).

One might argue that this premium rate, which is only an initial estimate, will not be sufficient to cover anticipated pay-outs, because the reinsurance scheme is itself an invitation to set up "collapsible plans" and then have the reinsurance plan pay off. Another feature of the bill, however, ought to be a substantial deterrent to such a practice -- the bill contains a subrogation scheme. That is to say, when a plan terminates with insufficient funds to pay vested benefits, the reinsurance fund will pay the difference -- with no delay attendant upon any controversy over whether or not the collapse was a "sham". But once those benefits are paid, the reinsurance fund is entitled to recover <u>from the general assets of the employer</u>, based upon a formula set forth in the bill, a proporation of the benefits paid out, depending upon whether or not the employer was solvent, and the degree to which he was solvent, at the time the plan was terminated (§405).

The reinsurance provisions of S.1179 are similar, but I see no comparable subrogation provisions -- a critical defect, in my view.

And of course the total <u>absence</u> of reinsurance in S.1631 again reflects an unwillingness to deal with the one problem which <u>caused</u> the movement for pension reform in the first place.

5. Fiduciary Standards

There is no longer very much controversy over these provisions. Title V of S.4 is practically a carbon copy of a similar bill introduced on behalf of the Nixon Administration (S. 1557) and is in most respects just about the same as bills introduced by others in the House and Senate.

The approach of the fiduciary standards title of S.4 is as follows:

(a) Who is a "Fiduciary"?

The term "fiduciary" is defined in the Act to mean not just the traditional trustee but also

> "any person who exercises any power of control, management, or disposition with respect to any moneys or other property of any employee benefit fund, or has authority or responsibility to do so."

I interpret this language to cover anyone holding decision-making power (whether he exercises it or not) with respect to investment of funds, determination of benefit eligibility, management of the plan, and so on. Thus, an investment counselor with a discretionary account would be a fiduciary; members of the labor-management "committee" would be ficuciaries; and even a personnel director certifying eligibility would be a fiduciary.

b. "Employee Benefit Funds"

This title applies not only to pension funds but also to all "employee benefit funds". The terms "employee benefit fund" and "employee benefit plan" are defined to include any plan or fund providing either welfare or pension benefits to employees, and would also include any "Taft Hartley" plan or fund permitted by Section 302(c) of the Labor-Management Regulations Act. In essence, the fiduciary standards of this bill would cover any plan (provided it is funded at all) which provides benefits of any kind to employees of a contributing employer. A quick rule of thumb would be that, if the plan is now required to file annual statements under the Welfare and Pension Plans Disclosure Act, it would be covered by the fiduciary standards in this act. But in addition to that, there does not appear to be an escape hatch for "unfunded" pension plans or retirement plans (unless any such plan is specifically exempted on other grounds), not because unfunded plans are covered, but because unfunded plans are now required to be funded.

c. Trust Requirement

The bill requires that every "employee benefit fund" be established or maintained pursuant to a duly executed written document setting forth the purpose of the fund and the "detailed basis on which payments are to be made into and out of such fund." The section also provides that "such funds shall be deemed a trust". The combination of these requirements requires that all pension funds be established pursuant to duly executed trust agreements and that the trust agreement provide, by its terms, the basis for determining both the contribution and benefit formulae.

d. The Prudent Man Rule

Any such fiduciary, under this bill, is required to discharge his duties with respect to the fund:

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

I read this standard to be somewhat stricter than many current state laws which occasionally set the standard as "with the care exercised by a prudent man dealing with his own money." S.4, on the other hand, provides, in a sense, a "prudent expert rule": the bill refers to a prudent man "acting in like capacity" (rather than acting with respect to his own money); the prudent man must be "familiar with such matters" (so that he cannot plead ignorance or lack of expertise), and the standard is the one which would be used "in the conduct of an enterprise of like character and with like aims" (so that he cannot argue that he had no experience or knowledge of the standards accepted in the conduct of such an enterprise).

e. Governing Documents

A violation of the governing documents also is a breach of fiduciary responsibility -- which gives the federal courts (under the enforcement provisions of the bill) jurisdiction not only to enforce the specific fiduciary standards but also to enforce the terms of the plan itself. The bill requires a fiduciary not only to follow the prudent man rule, but also to discharge his duties:

> "...in accordance with the documents and instruments governing the fund insofar as is consistent with this Act...."

f. Prohibited Transactions and Exceptions

Section 15 (b) of the Disclosure Act, as amended by S.4, would prohibit a fiduciary from engaging in nine specific transactions, in many cases subject, however, to exceptions thereafter provided in Section 15 (c), and further subject to the right of the Secretary to exempt a fiduciary from a prohibition in a specific case or class of cases.

(i) Prohibitions

(a) "Party in Interest"

The prohibited transactions are keyed to the definition of a "party in interest". The statute defines the term "party in interest" to mean

> "any administrator, officer, fiduciary, trustee, custodian, counsel, or employee of any employee benefit plan or a person providing benefit plan services to any such plan, or an employer, any of whose employees are covered by such a plan or any person controlling, controlled by, or under common control with, such employer or officer or employee or agent of such employer or such person, or an employee organization having members covered by such plan, or an officer or employee or agent of such an employee organization, or a relative, partner, or joint venturer or any of the above-described persons...."

The definition also requires that a person, to be treated as a "party in interest", must be "known to be a party in interest". A specific exception in the definition itself is that, if funds are invested in an investment company registered under the Investment Company Act of 1940, that investment shall not cause the investment company or its advisor or principal underwriter to be deemed to be either a fiduciary or a party in interest, except insofar as such investment company or advisor or underwriter acts in connection with an employee benefit fund as its investment advisor or underwriter.

The language is quite technical, but if one proceeds by analogy, one might conclude that, at the very least, most "insiders" under SEC rules would be parties in interest, and anyone employed by a plan or by a party to the plan would be a party in interest.

In short, once a person provides any service to the plan, the fiduciary should be on his guard against allowing that person to transact any business with the plan other than providing that service.

(b) Prohibited Transactions

The prohibited transaction provisions keyed to the foregoing definition of party in interest require that the fiduciary shall not:

> "(A) rent or sell property of the fund to any person known to be a party in interest of the fund;
>
> "(B) rent or purchase on behalf of the fund any property known to be owned by a party in interest of the fund;
>
> "(C) deal with such fund in his own interest or for his own account;
>
> "(D) represent any other party with such fund, or in any way act on behalf of a party adverse to the fund or adverse to the interests of its participants or beneficiaries;
>
> "(E) receive any consideration from any party dealing with such fund in connection with a transaction involving the fund;
>
> "(F) loan money or other assets of the fund to any party in interest of the fund;
>
> "(G) furnish goods, services, or facilities of the fund to any party in interest of the fund;

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

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

(ii) Exceptions to the Prohibitions

Section 15 (c) of the Disclosure Act, as amended by S.4, lists eight exceptions to the prohibitions. These exceptions, moreover, are not merely exceptions to the prohibitons as such but are exceptions to any prohibition in the statute, so that if the exception applies, the condúct described in the exceptions is not only exempted from the list of prohibited transactions, but, presumably, also would not violate the general "prudent man" standard.

Generally these exceptions include the right to receive a benefit (if a fiduciary is also a beneficiary); the right to receive reasonable compensation for services rendered, and reimbursement of expenses (but note that a full-time employee of the employer or the union may not receive compensation from the fund, although he may receive reimbursement of expenses); the right to be an officer or employee of a party in interest, in addition to being a fiduciary; the right to purchase securities of a contributing employer up to a maximum of 10% of the market value of the fund, but only if the purchase is for no more than adequate consideration (the 10% limit does not apply to profit sharing, stock bonus, thrift, or similar plans which allow such investments); the right to purchase a security from, or sell a security to, a party in interest if the security is in a class which is listed on a National Securities Exchange registered under the Exchange Act, or which has been listed for more than one month by a national security association administering an electronic quotation system, but only if no brokerage commission is charged and adequate consideration is paid, and, if the investment is in securities of the contributing employer, the transaction has prior approval of the Secretary of Labor; the right to loan money to participants or beneficiaries, if such loans are available on a non-discriminatory basis and "are not otherwise inconsistent with the purposes of this Act" (presumably a reference to the prudent man rule); and the right to contract with a party in interest for office space and other necessary services.

(g) Liabilities of Fiduciary

The bill makes any fiduciary personally liable for any losses to the fund resulting from a breach of fiduciary standards. The real teeth in these standards are found in the enforcement provisions of the whole Act, however, as further described below.

(h) Co-Fiduciaries, and Allocation of Responsibilities

Sections 15(e)-(g) deal with the liabilities of a fiduciary for acts of another fiduciary.

Section 15(e) provides that when two fiduciaries undertake the exercise of a power jointly (or when they are required to by the governing instrument) each fiduciary has a duty to prevent the other from breaching his responsibility -- and so a fiduciary would be liable for failure to prevent the other from committing a breach. The statute provides for exemption from liability if the objecting co-fiduciary "objects in writing to the specific action and promptly files a copy of his objection with the Secretary".

Section 15(f) nullifies all exculpatory clauses by providing that "no fiduciary may be relieved from any responsibility, obligation, or duty imposed by law, agreement or otherwise." But Section 15(f) provides that fiduciaries may by agreement allocate specific duties or responsibilities among themselves by submitting to the Secretary contractual provisions to that effect, which become effective "unless specifically disapproved by the Secretary".

A fiduciary seeking to insulate himself from liability for the misconduct of another fiduciary, therefore, would do well to provide, in a written instrument, the limits of his own responsibility, and the specific allocations of various responsibilities among fiduciaries. This instrument should be submitted to the Secretary, and becomes effective immediately, unless the Secretary disapproves it.

Finally, Section 15(g) provides that the fiduciary has no liability for a violation committed before he takes office.

(i) Double Fees or Commissions Prohibited

A provision of the original bill (S.4) (deleted in Committee) expressly permitted a "party in interest" to provide multiple services to the plan. The following language from the Committee Report explains the deletion of that provision:

> "In this connection, the Subcommittee, after careful deliberation, deleted a prior provision, section 15(d), which expressly permitted a 'party in interest' to provide multiple services to a plan, regardless of whether the 'party in interest' was also serving in a fiduciary capacity and receiving fees or compensation for the performance of discretionary functions with respect to plan funds.
>
> "Section 15(d) had been predicated on the recognition that fiduciaries, subject to regulation and supervision under laws affecting banking, insurance and securities, performed a variety of services and functions, some customary and rooted in the historical development of the fiduciary's role, and some newly arisen as a means of strengthening the fiduciary's competitive position.
>
> "Many of these multiple services or functions are or could be rendered in connection with a variety of trusts or funds other than pension trusts or funds. Examples are widows' estates, mutual funds, college

endowment funds, variable annuity funds, etc. Because the fiduciary's conduct relative to the performance of multiple functions was subject to regulation under laws affecting insurance, banking and securities, the Committee originally took the position that additional regulation in this field should proceed sui generis under these laws. The Committee believed that the bill provided ample remedy in the event, for example, the fiduciary breached his trust by 'churning' pension fund accounts to generate profit for himself or ancillary activities under his control, or by channeling pension fund investment to shore up vulnerable investments made by a commercial adjunct.

"Upon review by the Subcommittee of section 15(d), however, a competing school of thought emerged, which emphasized the difficulty of securing an adequate system of control over fiduciary-commercial relationships in the context of pension fund management. It was argued that these relationships tend to subordinate the strict professionalism expected of fund managers to business pressures and that, inevitably, certain fund managers are bound to yield to these pressures and cause trust fund abuse in a manner which is not always accessible to timely discovery. Because the interests of pension fund beneficiaries deserve the strongest protection, it was urged that the Subcommittee adopt a rule which would bar a fiduciary from performing multiple business services for the pension trust unless, after application by the fiduciary, the Secretary waives the proscription on grounds that it is consistent with the purposes of the Act and is in the interest of the fund or classes of funds and the participants and beneficiaries."

(j) Effective Dates

While there is a three-year delay between enactment and the effective dates of some of the provisions of S.4 (e.g., vesting and funding), the fiduciary standards provisions in Title V become effective upon enactment of the Act, as do the enforcement provisions in Title VI.

Despite the immediate effectiveness of Title V, however, there is another three-year delay in that title with respect to disposal of assets held in violation of a fiduciary requirement. Proposed Section 15(j) provides that a fiduciary may in his discretion effect the disposition of an investment prohibited by the Act "within three years after the date of enactment of this Act", and further provides that the Secretary may by rule or regulation allow additional time.

(k) Fiduciary Standards in S.1179 and S.1631

Both these bills proceed in the traditional tax way -- violations of "prohibited transactions" would result in tax penalties. I cannot imagine this approach providing a decent measure of protection for beneficiaries -- indeed, the Administration concedes as much by its submission of S.1557 as a companion bill to S.1631.

6. Enforcement Provisions

The enforcement provisions of S.4 are as follows.

Section 601 permits the Secretary of Labor to bring a number of actions to enforce compliance with the registration requirements of the Act (aimed primarily at vesting, funding and re-insurance).

Section 602 provides that when the Secretary has "reasonable cause" to believe that a fund is being administered either in violation of the WPPDA or the fund's governing documents, he may petition any U. S. District Court for appropriate relief, including an order requiring return of funds unlawfully transferred, payment of benefits, or restraining any conduct in violation of the Act, and may compel the removal of a fiduciary under appropriate circumstances.

Section 603 provides that actions of this kind may be brought in any state court or federal district court without regard to the amount in controversy or diversity of citizenship of the parties, and venue is laid in any district where the plan is administered, where the breach took place, or where a defendant resides or is found, and -- most importantly -- process may be served nationwide.

Section 604 provides that a participant or beneficiary may likewise bring suit under similar guidelines.

Section 605 permits the court in its discretion to allow a reasonable attorney's fee as part of costs to <u>either</u> party, and may require a plaintiff to post security for such costs.

Section 607 allows judicial review of any action of the Secretary.

Section 608 sets a statute of limitation of five years for a violation of fiduciary standards, except that, in case of fraud or concealment, the statute is tolled until date of discovery.

The enforcement provisions of S.1631 and S.1179, on the other hand, are essentially those under existing tax law --

a tax penalty to the violator, but few if any real remedies for the pension participant.

7. Federal Preemption

Section 609 of S.4 preempts all state laws dealing with the same subject matter as S.4 or the Welfare and Pension Plans Disclosure Act as amended, with certain stated exceptions. The operative language of 609 is that the provisions of S.4 and of the WPPDA "Shall supersede any and all laws of the States and of political subdivisions thereof insofar as they may now or hereafter relate to the subject matters regulated by [S.4] or the Welfare and Pension Plans Disclosure Act...."

The exceptions are -- (1) plans not subject to S.4 or the WPPDA; (2) statutes regulating insurance, banking, or securities, or requiring the filing with a State of copies of reports filed under S.4; and (3) any federal statute not directly in conflict with S.4.

Obviously, if the States are to legislate in this field, only chaos can result, in the absence of preemption -- and one need only examine a recent New Jersey law on the subject to see a good example.*

The tax bills (S.1631 and S.1179), on the other hand, cannot reasonably be expected to preempt all State laws -- not

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* H.B.1563, effective May 9, 1963. Under this new New Jersey law, the State imposes a tax upon employers closing plants in the State, the tax being, generally, an amount sufficient to pay off pensions for workers with 15 years of service, whether vested or not.

because preemption is undesirable, but because their enforcement provisions are so weak that preemption would leave a vacuum and would leave pension participants almost remedy-less, as they are today.

F. Tax-Deductible Contributions

Obviously, no tax features can be added to S.4, or to any Senate Bill, without making the bill unconstitutional (as tax legislation not originating in the House).

But there are tax features which ought to be enacted -- not as a substitute for S.4, but in addition to it.

Obviously, some treatment for the unjust lump-sum distribution treatment, which hits a pensioner withdrawing from one plan before entering another, is required.

More importantly, we need an expansion of Keogh, and we need it for corporate employees (common law employees) as well as for the self-employed.

These features of S.1631 and S.1179 are sorely needed, particularly by workers who have no pension coverage at all (50% of the work force, primarily in small business). But the $1500 limit on the self-employed is too low. I see no reason not to make both limits $7500.

And I see no reason for lowering the limit by the amount the employer contributes, when the employer's contribution is not vested, and the employee's is.

G. <u>A Comment on the More Extreme Proposals</u>

None of these bills is perfect -- none eliminates <u>every</u> possibility of forfeiture.

Any vesting standard makes a judgment: how long must an employee work before it would be unfair and unjust to allow him to forfeit because he changes jobs?

Of course it is always possible to go farther. It is possible to set up an immediate-vesting standard as a matter of law. It is possible, as one of my co-panelists has suggested, to take the private pension system and completely divorce it from the employer-employee context -- to set up a set of independent funds, regulated by the government, which would amount to a private social security system.

While that notion has a certain superficial appeal, it is, in my judgment, utterly preposterous, because it leaves out the most essential element -- business incentive. Why should an employer involve himself in a plan if he gets no credit for it, if he is not permitted to put his name on it, if he is not permitted to "tailor" it (within limits) to fit the special needs and desires of his own workforce and his own business? If we put this industry in a straightjacket, if we so standardize pension plans that no flexibility is left, we will most assuredly (and unnecessarily) kill, or at least mortally wound, the industry we are trying to improve.

There will always be those who will find fault with any bill -- who will say "more" and "more", without regard to possible adverse side-effects. Indeed, there are those who have said that with respect to S.4, and even with respect to the more conservative bills.

But S.4 is a moderate bill -- it is compatible in all respects with the essentially private nature of the pension industry. The "radical" proposals (as I characterize them) are not.

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IV. Costs

The Senate Labor Committee retained a Baltimore actuarial firm to analyze the potential cost impact of the various vesting formulae, and the results have been published. (S. Rep. No. 1150 92d Cong., 2d Sess. 149-150 (1972)).

The summary of these results, as they appear in the actuarial report, is as follows:

RANGE OF INCREASE IN PENSION PLAN COSTS
FOR MANDATORY VESTING PROVISIONS

	PRESENT VESTING: NONE	PRESENT VESTING: MODERATE	PRESENT VESTING: LIBERAL	ALL PLANS
Percentage of Pension Plan Members Covered Under Such Plans	23%	56%	21%	100%
Range of Present Plan Cost as a Percent of Payroll	1.8%-10.4%	2.2%-11.8%	2.2%-11.9%	1.8%-11.9%
Range of Increase in Cost as a Percent of Payroll				
1. 30% at 8 years, graded, no past service vested	0.2%-0.6%	0.0%-0.2%	0.0%-0.0%	0.0%-0.6%
2. 30% at 8 years, graded, all past service vested	0.2%-1.4%	0.1%-0.3%	0.0%-0.0%	0.0%-1.4%
3. 30% at 8 years graded, past service vested for members age 45 and over	0.2%-1.2%	0.1%-0.2%	0.0%-0.0%	0.0%-1.2%
4. Rule of 50, no past service vested	0.2%-0.7%	0.0%-0.3%	0.0%-0.2%	0.0%-0.7%
Range of Increase in Cost as a Percent of Present Plan Cost				
1. 30% at 8 years, graded, no past service vested	3%-25%	0%-6%	0%-1%	0%-25%
2. 30% at 8 years, graded, all past service vested	5%-53%	1%-8%	0%-1%	0%-53%
3. 30% at 8 years, graded, past service vested for members age 45 and over	5%-44%	1%-6%	0%-1%	0%-44%
4. Rule of 50, no past service vested	3%-20%	0%-12%	0%-5%	0%-20%

S.4, therefore, is assumed to increase costs for current plans with "moderate vesting" plans by about 0.1% to 0.2% or 0.3% of payroll (depending on the extent of retroactivity).

Obviously, in an economy in which wages have increased more than 5% per year in recent times, this cost is manageable.

There are some <u>other</u> substantial though less visible costs in the bill, however. It is no secret that many a conglomerate has gobbled up a smaller company and immediately dicontinued its pension plan, leaving vested and other benefits without adequate funding. The new bill has the effect of reinsuring the unfunded vested benefits of such a terminated plan, but of requiring a solvent company -- one which terminated a plan at its own convenience -- to refund the federal reinsurance benefits, based on a ratio between the company's net worth and the reinsurance benefits paid (§405). The effect is to force an acquiring or merging company to include unfunded pension cost in the calculus of assets and liabilities used to determine the selling price of an enterprise. In my judgment, that will be a "cost" only if the enterprise is not thereby deterred from arbitrarily terminating a plan. The deterrant effect, in my view, is substantial and worthwhile.

V. Conclusion

No law or amendment to law can solve all of the problems in this field. A bad law or a misconcieved law can make things worse -- either by deluding workers into believing they are protected when they are not (which would <u>not</u> be an improvement), or by so entangling pensions in bureaucracy as to deter private pension plan development.

What would a good law be? In my view, we need both substantive regulation, and new tax incentives.

I proceed on the following premises: (1) If you want to regulate, do it directly, by substantive regulatory control and not by tax qualifications; (2) If you want to create incentives for voluntary conduct, tax is an excellent vechicle.

Following those guidelines, I conclude that the current Williams-Javits bill S.4 is a workable regulatory structure for establishing minimum standards for private plans, and for protecting private rights -- rights in dispute between private parties -- under those plans.

Even so, tax reform in the pension field is needed -- sorely needed -- to solve critical problems which are beyond the scope of S.4 and can only be solved by tax incentives.

The two most serious problems beyond the scope of S.4 are: First, the 50 percent of the work force not covered by any pension plan; and second, the vast numbers of employees in high-mobilityemployment (such as engineers), who, although they are often "covered" by corporate pension plans, rarely vest and will not be helped by any pending vesting bill, because they regularly change jobs every five years or more frequently than that. The most promising solution to both problems is in the individual before-tax retirement act, such as is proposed in the features of S.1631 and S.1179 (other than those dealing with vesting and funding).

Let the high-mobility engineer, who cannot vest under his corporate pension plan, contribute his own money to his own "plan", and get a tax deduction for the contribution.

Let the employee of the small business without a company plan contribute his own money to his own plan on a deductible basis.

That is the only effective way to solve the remaining coverage problem.

Should it be done? Can the nation afford the revenue loss?

We are already paying the cost of wide-spread destitution in old age. We pay it in welfare costs and all sorts of public assistance to older people who worked hard during their earlier years, who had pride in themselves and in their abilities, but who nevertheless are unable to provide for themselves any longer.

Why not give them the dignity of being able to live in their retirement years on money they earned?

That is what we do, to a very limited extent, under Social Security, but we all know very well that Social Security, at best, will never provide much more than a bare subsistance income level.

Why should we condemn the typical middle-class American, who has lived his whole working life on a middle class income, to be thrown, suddenly at the age of 65, into the very bottom of our economic barrel?

There is no better, more fundamental, more humane allocation of our resources than this.

And whose resources are we talking about, anyway? This is not welfare -- reallocating money from the rich to the poor. This is simply giving a man the use of his money, which he earned, but giving it to him when he needs it most, and letting him pay taxes on it then.

The average American ordinarily hates tax "loopholes" because they offer him nothing but a reason to be angry at someone else -- the oilman, the securities investor, and so on.

But retirement is part of <u>every</u> American's expectations. In my judgment, our top priority should be to take some of the fear out of retirement, and to put some security and dignity into it instead.

STATEMENT ON PENSION PLAN
REFORM LEGISLATION

before

THE PRIVATE PENSION PLANS SUBCOMMITTEE OF THE
SENATE FINANCE COMMITTEE

by

LEONARD LESSER
June 4, 197

This statement is submitted in response to the Committee's invitation to participate in this panel discussion on pending pension reform legislation.

It will not set forth the statistics to demonstrate the importance of private pension plans as economic or social institutions in American society today. This committee and the other committees in both the Senate and the House have over at least the past ten years received volumes of testimony to this effect.

This Subcommittee is also aware of the basic shortcomings of the private pension system. Too many workers who are covered by private pension plans do not and will not receive a pension from such plans when they retire.

S. 4 reported to the Senate currently by the Labor and Public Welfare Committee, S. 1179 introduced by Senator Bentsen, and S. 1631 introduced by Senator Curtis and others all propose a solution to these shortcomings.

Before discussing the substantive provisions on vesting, particularly, termination insurance and funding, I believe it is important to consider the approach of the various bills.

S. 4 would require all plans to contain minimum requirements on vesting, funding and termination insurance. S. 1179 and S. 1631, on the other hand, would only require it of plans where the employer wants the tax advantages given to "qualified" plans. I believe the distinction is significant. It goes beyond the question of whether the requirements should be administered by the Department of Labor or the Internal Revenue Service. It goes to the heart of whether protection will be afforded to all workers or only those workers whose employers are concerned with current tax deductions.

There can well be cases where protection will be lost because the employer for tax reasons has no incentive to make either contributions to the plan or premimum payments for pension termination insurance.

Just as the applicability of fiduciary and disclosure requirements are not dependent on whether the employer seeks tax qualification, so too should the protection of employees under the substantive regulations be mandatory plan provisions.Of course, such recommendations would not preclude that they also be a condition of tax qualification. The same government agency could make the determination for both purposes.

To make protection as broad as possible, I would suggest, however, that the coverage limitation to employers with 25 or more employees in

S. 4 be removed. The employees of small employers are most in need of protection -- particularly from the risks of insolvency of their employer. I do not believe the extension to small employers will be a serious deterrent to their establishment of plans.

While S. 4, S. 1179 and S. 1631 all propose minimum vesting standards, there is a basic difference of approach as to whether the requirements should be applicable to benefits accrued prior to establishment of a pension plan or the effective date of the new legislation.

S. 4 makes no distinction between service performed for an employer before or after the time a pension plan was established. The vesting and termination insurance requirement are applicable to all service. S. 1179 requires that credit be given for prior service at least if the employee is 45 years older on the effective date of the Act. S. 1631 would, subject to certain exceptions, make vesting requirements applicable only to service rendered after January 1, 1975.

It is obvious that a proposal which disregards prior service gives little protection to those who are closest to retirement age and are least able to accrue adequate benefits in the future.

The "Rule of 50" proposed in S. 1631 does not meet the problem. It only results in vesting after a short period of service; it does nothing to preclude the denial of benefits or assure the payment of benefits based on the full period of service required to accumulate an adequate benefit. Nor will the proposal to permit tax deductions (S. 1631) tax or credit (S. 1179) for employee contributions meet the problems for workers whose future years of work are limited.

I would therefore strongly recommend that the Congress, unless it intends to enact legislation which is meaningful only for those who will retire sometime in the future, require that full consideration be given to "past service."

Turning to the specific requirements for vesting, I believe that all employees who have had a significant period of service for an employer should be entitled to a pension based on such period of service. As indicated, I do not believe it matters whether such service is performed before or after the effective date of the pension plan. Similarly, I do not believe that service performed before a certain age should be excluded. For that reason, I do not believe the "Rule of 50" is sound since it would permit the exclusion of significant periods of service before age 40. This is particularly true since S. 1631 also allows all service prior to age 30, to be disregarded. The generation of relatively insignificant pensions for older workers with very short periods of attachment to a particular job hardly outweighs its disadvantages.

I believe that 10 years is a long enough period of service to acquire full vesting. Such a standard would be most understandable and would not lead to excessive increases in costs.

While S. 1179 provides for some vesting after 5 years of service, the percentage increase of 5 per cent a year requires that 20 years of service be completed before there is full vesting. If the percentage were increased to 7½ per cent, the required period for full vesting would be shortened to 15 years, the same as in S. 4.

While all of the legislative proposals permit transition periods -- presumably to soften the cost impact of vesting requirements -- it should be recognized that any delay means that no protection will be afforded to workers who terminate their employment prior to the final date. Consideration might be given to use of the funding provisions to soften the cost impact rather than to delay the effective date of the vesting requirement. For example, the additional cost applicable to the vesting requirement during the transition period could be deferred for the period and then at the expiration of the transition period be considered a "past service" cost which would be funded over a fairly long period. I am certain that those with technical competence can devise other methods that will not require delay in the protection which workers so urgently need.

Closely related to the objectives of vesting is the concept of pension portability. Its basic purpose to protect employees against the forfeiture of pension rights is just as well met by adequate vesting, funding and termination insurance provisions.

While the consolidation of pension credits in a single fund which would result from a system of portability will reduce the possibility that a worker will forget to apply for a vested benefit accrued years ago, this goal can be achieved without the transfer of funds or the establishment of elaborate procedures. All pension plans should be required to provide information on vested benefits to the Social Security Administration for inclusion in an individual's social security record. When the individual applies for social security he will be notified of his rights to vested benefits and how application should be made.

While the transfer of funds may help in protecting a worker against the erosion in the value of his vested benefits, such problems might better be met directly. Others have proposed the issuance by the government of purchasing power bonds, the value of which would increase to provide cost of living protection. The availability of such bonds would permit a pension fund to provide protection of this type to vested benefits.

While vesting is essential to protect workers of pension protection upon termination of a job, yet as Senator Bentsen stated in introducing S. 1179, "Pension reform without minimum funding standards and required insurance is really no reform at all."

Funding requirements are desirable to enhance the security of benefit expectations. Termination insurance, however, is essential to provide full assurance that all benefits will be paid in the event of plan termination.

It should also be recognized that while funding and vesting provisions can be improved by an employer alone or by the union and the employer if the plan is collectively bargained, legislative action is necessary to meet the problem of insufficient assets in the event of plan termination.

While increased funding will generate more assets, the ever-changing character of private pension plans makes it extremely likely that full funding will never be achieved. Every time a plan is improved to meet inflationary pressures or changing economic conditions -- and if private plans have a virtue, this is it -- additional past service liabilities are created and an additional 30 years is required to achieve full funding.

Since the introduction of the first proposal for pension termination insurance by Senator Hartke in 1964, the various proposals have been studied and restudied and the basis for opposition has shifted. It is now generally agreed that such a program is technically feasible. The basic objection now centers around the argument that the magnitude of benefit loss is not sufficient to justify the establishment of a program covering all pension plans; and that the establishment of a program will invite pension abuses.

While the recent Treasury - Labor Department Study of Pension Plan Terminations has been used as a justification by the administration to recommend further study of the problem, it does show that during the first seven months of 1972, 8400 individuals lost some $20 million in benefits. The average benefit lost was $2,400.

I would doubt that the percentage of banks that go out of business or investors who lose funds when brokers experience financial difficulty is any greater than shown by the study, yet the FDIC continues as a Congressionally mandated program and the Securities Investor Protection Corporation was passed by the Congress and signed into law by the President in 1971.

A worker whose savings for retirement are in a pension fund is as worthy of protection as the bank depositor or the stock market investor His needs for protection are as great as the holder of a FHA or other insured mortgage who is protected against the inability of the mortgagee to make good on his obligation.

Rather than being an objection to establishment of a program, the small percentage of terminations or workers affected only demonstrates that the cost of preventing the personal tragedy suffered by those who are affected will be very low.

Both S. 4 and S. 1179 which would include termination insurance provisions, contain safeguards against possible abuse of the insurance fund. Neither Bill would insure liabilities created by increases in benefits which resulted from plan amendments occurring in the three year period prior to termination. S. 4 would also require an employer to accept some liability for losses resulting from termination of his plan.

Both S. 4 and S. 1179 also make a distinction between multi-employers and other plans in establishing a termination insurance premium rate. In view of the risks of individual employee terminations which are borne by multi-employer plans and the recognition which both bills also give to single employer plans who have previously exercised responsibility in funding prior service liabilities, I would support such distinction. At the same time I would strongly urge that any legislation not permit experience making -- that is variations from the uniform rates by individual plans whether they be single employer or multi-employer.

Let me conclude by urging this Committee to act promptly so as to facilitate the adoption by the Senate of legislation to improve the effectiveness of the private pension system in meeting the needs of covered workers.

As it makes its decisions, I would hope that the Committee, for the reasons I have indicated, will keep in mind:

1. the <u>necessity</u> for termination insurance in order to adequately protect the benefit rights of employees whose private pension plan is terminated;
2. the <u>necessity</u> for the vesting of benefits accrued by all periods of service -- regardless of whether performed before or after the enactment of legislation or the establishment of a plan.

Legislation along the lines of S. 4 which incorporates these principles together with funding and disclosure and fiduciary responsibility requirements will represent a forward step in the necessary reform of the private pension system.

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