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PROTECTING THE PENSIONS OF WORKING AMERICANS: LESSONS FROM THE ENRON DEBACLE

HEARING

BEFORE THE

COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE IMPACT OF THE COLLAPSE OF ENRON CORPORATION ON ITS 401(k) PENSION PLAN INVESTORS AND THE DEPARTMENT OF LABOR'S ROLE IN ENFORCEMENT AND REGULATION UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT (ERISA), FOCUSING ON RELATED PENSION PLAN REFORM PROPOSALS

FEBRUARY 7, 2002

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PROTECTING THE PENSIONS OF WORKING AMERICANS: LESSONS FROM THE ENRON DEBACLE

THURSDAY, FEBRUARY 7, 2002

U.S. SENATE,
COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS,
Washington, DC.

The committee met, pursuant to notice, in Room SD-106, Dirksen Senate Office Building, Hon. Edward M. Kennedy (chairman of the committee) presiding.

Present: Senators Kennedy, Dodd, Mikulski, Bingaman, Wellstone, Reed, Edwards, Clinton, Gregg, Enzi, Hutchinson, Warner, Bond, and DeWine.

OPENING STATEMENT OF SENATOR KENNEDY

The CHAIRMAN. The committee will come to order, please.

We have a number of very important events, one of which is the prayer breakfast which a number of our colleagues have attended, and they will be returning as we start to move through the hearing. Then, we have a vote just after 10 and another at noon. So we will be interrupted, unfortunately, but that is the way that life is.

At the outset, I will make an opening statement, then ask Senator Gregg to make what comments he would, and then move to our Senate colleagues and then to Congressman Bentsen.

We are here today to learn lessons from the Enron debacle so that we can strengthen America's pension system and protect America's workers.

At Enron, executives cashed out more than $1 billion of stock while Enron workers lost more than $1 billion from their 401(k) retirement plans. Thousands of Enron workers lost virtually all of their retirement savings. Enron executives got rich off stock options even as they drove the company into the ground and systematically misled workers about the true financial condition of the company.

Sadly, Enron is not just an isolated tale of corporate greed. Instead, the Enron debacle reveals a crisis of corporate values. In America, people who work hard all their lives deserve retirement security in their golden years. It is wrong—dead wrong—to expect Americans to face poverty in retirement after decades of working and saving. Enron has shown us that workers today do not have true retirement security.

The emerging details of the Enron scandal reveal a shocking abuse of corporate power that left workers powerless to protect

themselves. Executives like those at Enron should not put their own short-term gain ahead of the long-term interests of workers and shareholders. They must not be rewarded for doing so. Above all, the Enron debacle demonstrates the urgency of reforming 401(k) plans which are now the bedrock of America's pension system.

I commend President Bush for proposing legislation to provide fair notice for workers before any lockdown and to end age restrictions on the sale of company matching stock.

But these first steps only address the tip of the iceberg in terms of protecting workers' retirement security. The President's proposal does nothing to respond to the core issue—the need for investment diversification to protect workers at Enron and other companies across the United States. When it comes to protecting the hard-earned retirement dollars of America's workers, we should not settle for half measures.

At Enron, workers were systematically misled by Enron executives about the financial situation of the company. For years, Enron, like many other companies, pushed its workers to buy company stock with their own 401(k) contributions. As a result, Enron workers had more than 60 percent of their 401(k) assets in Enron stock. They were turned into captive investors who could not sell their stock when they needed to or wanted to. Workers at many of America's leading companies face similar risks because they are overinvested in company stock. At Proctor and Gamble, for example, workers have over 90 percent of their 401(k) assets in company stock.

Until the bitter end, Enron executives continued to tout Enron stock to workers in a series of emails. On August 14, CEO Kenneth Lay told workers that he "never felt better about the prospects for the company." On August 27, Lay predicted to workers a "significantly higher stock price." And on September 26, Lay called Enron stock "an incredible bargain." Even as they promised the moon, Lay and others were cashing out their stock for $1 billion.

Enron is not an isolated example. The retirement security of workers at many other major corporations has been similarly undermined. At Lucent, the company's stock dropped from a peak of $45 to $6 last August. Lucent's workers lost millions because they were overinvested in company stock. At Polaroid, workers were required to invest in company stock and barred from selling until they retired. As Polaroid went bankrupt, the workers lost virtually their entire retirement savings.

A generation ago, Congress took action to safeguard pensions in response to an Enron-like debacle at Studebaker. These protections for defined benefit plans included diversification requirements and Government insurance. As many companies have abandoned the traditional defined benefit pension plans, 401(k) plans have become the bedrock of America's pension system. Today 401(k)'s offer few if any of these safeguards for workers' retirement security; 401(k) plans are not professionally managed, they are exempt from diversification standards, and they are not backed by insurance.

In the wake of Enron's collapse, Americans across the spectrum now recognize that a successful free enterprise economy depends on a framework of laws and institutions to make it work. Enron ex-

ecutives were some of the leading cheerleaders for deregulation, arguing against any kind of Government oversight. The results are now in, and it is clear that this approach leaves America's workers high and dry.

Above all, the Enron debacle shows that we need a top to bottom review of 401(k) plans. But we must do more to protect the retirement security of workers. We must take concrete steps to foster the diversification of workers' 401(k) plans. Companies should be required to adequately insure their pension plans and to give workers a voice in overseeing pension plans. We must guarantee that workers receive complete and accurate information to make their investment decisions and make clear that executives cannot give workers incomplete or misleading information to affect their stock purchases.

I look forward to hearing from our witnesses today and moving forward on legislation to reform America's pension system.

Senator Gregg?

OPENING STATEMENT OF SENATOR GREGG

Senator GREGG. Thank you, Mr. Chairman.

Today we are taking up one of the areas that has been raised relative to the Enron situation. There has been an immense amount of hyperbole on the issue of Enron, but when we get past the circus and take away the screen, we find two major public policy issues.

The first public policy issue goes to the issue of accounting and the question of transparency and the accuracy of accounting systems and the integrity of our accounting process.

The second issue goes to the issue of pensions and especially the investment in and ownership of company stock by employees.

Ironically, in the Enron situation, the first issue, the integrity of the accounting system and transparency, affected the second issue rather dramatically because, as we have read, there have been dramatic losses in the value of the Enron stock. But had there been accurate and forthright accounting in place, the stock probably would have never reached the values that it was alleged to have attained, and the issue of losses here would be significantly different.

As we move down this road of determining what we should do to reform our pension system, which is the topic of this hearing, I think we need to be careful. We need to be sure that we do not end up throwing the baby out with the bath water.

Literally millions of Americans have seen their avenue to wealth being their participation in their company's stock. The number of companies that have aggressive stock plans and the number of rank-and-file employees who have benefited from those are millions—the clerk who works at a checkout counter at a Safeway store; the person who manages the women's apparel section of a Wal-Mart store; the individual who sells appliances in a Sears store; the salesperson for a pharmaceutical company. These individuals, after years of hard labor for the corporations that they work for, end up retiring with significant wealth—in fact, in some instances, hundreds of thousands and even millions of dollars worth of wealth.

We do not want to set up a system here which dramatically chills that opportunity for American workers to participate in their true future, in their future in the American dream, their participation in capitalism.

So as we look at the issue of diversification, which is an important issue, and as we look at the issue of vesting, which is an equally important issue, we need to be concerned with the question of whether Enron is an aberration or whether this is a systematic failure. Looking at that question, I believe we should look across the structure of corporate America, look at companies like Raytheon, for example, in Massachusetts, which has set in place a stock ownership plan which allows for immediate vesting, look at companies like Bank of Boston, Bay State Gas, Biogen, Houghton and Miflin, L.S. Serratt, New England Power, Staples, Stone and Webster—the list goes on and on of companies that have turned over a significant portion of the value of the assets of the corporation to their workers through various forms of stock incentive plans—and be sure that we do not end up, as a result of actions taken by a Congress, which is running before the media, chilling the rights of stockholders who are workers to have access to that form of wealth.

So let us take a look at what happened with Enron and then let us make decisions which are based on logic and which are going to continue to promote the expansion of wealth amongst rank-and-file employees in America and not end up taking actions which will cut off their access to that form of wealth.

The CHAIRMAN. Thank you very much.

We will include in the record statements of Senators Harkin, Roberts and Hutchinson.

[The prepared statements of Senators Harkin, Roberts and Hutchinson follow:]

PREPARED STATEMENT OF SENATOR HARKIN

I thank the Chair for holding this hearing. There is a strong need to round out everyone's knowledge of what went so horribly wrong for Enron pension holders, and what kind of remedies we can enact in Congress to prevent another tragedy.

Enron and pension reform isn't about politics. It's about Iowa families like the Heilands. I recently received a letter from Sheri Heiland. Sheri shared with me the story of how Enron's duplicity cost her parents their pension.

Sheri's father worked at Northern Natural Gas in Redfield for 30 years before passing away in 1979. Those decades of hard work earned him a good pension. But when Enron bought out Northern Natural Gas that companies stock was transferred into Enron stock.

As Enron's stock plummeted, Sheri's mother, a 77 year old widow living alone in Penora, lost much of her retirement savings. In her letter, Sheri told me that her mother trusted Enron and Ken Lay "to be honest and above board." Now, Sheri's mother can no longer afford to repair her home, making it more difficult for her to continue living on her own.

Families like the Heilands are why we need to act immediately to protect worker pensions. We don't yet know if Enron broke any

laws, but they clearly undertook a series of actions that undermined their workers retirement and emptied the pensions. That's why I believe that our pension protection legislation should emphasize the creation and preservation of employee pension plans that are secure, transparent and fair.

That means prohibiting a company's accountants from also auditing employee pension plans; requiring companies to carry insurance to cover employee pension losses due to company fraud; establishing an Office of Pension Protection at the Department of Labor to act as an advocate for pension holders and provide genuinely understandable information on things that really matter to a pension plan participant.

We should also require that "blackout" or "lockdown" periods, where stock may not be traded, affect company executives the same way they affect other employees, so that executives like Ken Lay cannot unload their stock, while his employees lost both their jobs and their life savings. And when executives do dump stock those actions should be reported in a timely manner, not a month or a year later when the damage has already been done.

And the federal government shouldn't provide tax breaks to companies that fail to provide employees diversified portfolios. Some companies, like Enron, encourage their employees to be heavily invested in their companies stock. The United States Government subsidizes 401(k) plans for a reason—to provide employees with a retirement plan that should be unlikely to crash.

I believe the Congress and the president must make clear—in both actions and words—that a worker's pension is not a corporation's private piggy bank. While most employers do right by their workers, we must protect workers and their pensions from the Ken Lays of the world. I look forward to working with President Bush and my colleagues on this committee to make these needed pension reforms. I thank the chair.

PREPARED STATEMENT OF SENATOR ROBERTS

Mr. Chairman: Thank you for calling this hearing to consider the important issue of ensuring the security of American workers' retirement plans.

In the aftermath of Enron, Congress has a responsibility to assure America's workers that we are taking the necessary steps to protect and preserve their retirement assets. We are here today to begin the process of gathering the facts surrounding the Enron case, examining current pension practices and determining what steps Congress can and should take to safeguard worker's retirement savings.

It is important for us to keep in mind, as we hear testimony today, that we don't yet have all the facts in the Enron case. I commend Secretary Chao and the Department of Labor for moving quickly to investigate Enron's retirement savings plan. It is important that we allow this investigation to continue to determine to what extent Enron violated its fiduciary responsibility to its employees and ascertain the facts surrounding the loss of Enron worker's retirement plans before we take legislative action to alter pension law.

The case of Enron has brought to light many issues about current pension law that merit review. A key issue is giving workers the freedom to diversify their retirement accounts. While employees should retain the option of investing in employer stock, they must also be allowed other investment options in a more timely manner. We must ensure parity between corporate executives and workers during blackout periods and require that employers accept fiduciary responsibility for their employees retirement savings during blackout periods. Employees must have accurate information and have access to investment advice about their retirement plans and investment options. As we consider ways to strengthen and protect the private pension system, we must not restrict workers ability to make their own investment decisions about their retirement plan.

Voluntary employer-sponsored pension plans, like 401(k) plans are a valuable way for more than 42 million Americans to save for retirement. As we review pension law, we must be careful that any Congressional action does not jeopardize worker's retirement savings by discouraging employers from providing retirement savings plans.

I want to thank my colleagues who have already proposed changes to current pension law. I am confident that these, along with President Bush's proposal to safeguard American workers' retirement savings will give us an opportunity for a thorough examination of what measures are necessary to protect and preserve workers' retirement plans, empower workers to make their own investment decisions, and encourage companies, both large and small, to continue offering retirement plan benefits to their employees.

Again, Mr. Chairman, I thank you for calling today's hearing.

PREPARED STATEMENT OF SENATOR HUTCHINSON

• What brings us here today is a tragic loss of thousands of people's retirement security. For anyone who has been watching the story of the failure of Enron unfold, it is obvious that there is plenty of blame to go around. The company executives, the auditors, the board, lax regulators, and the pension plan administrators have all come under scrutiny as numerous investigations, conducted by federal, state and private entities, seek to uncover the truth.

• In this Committee, we have a narrow focus on what is by far the most heartbreaking aspect of the bankruptcy: over twenty thousand individuals invested in Enron retirement plans which held significant shares of company stock, a stock which depreciated in value by 98.8% in 2001. The plan sustained $1 billion in losses.

• Such a catastrophic loss begs a culprit. Whether one exists, whether our laws are strong enough to punish any culprits and whether restoration will be available for those who have lost their retirement savings are certainly questions I hope to look into today.

• But the members of this Committee are also very aware that the culprit may be flaws in the system of laws we oversee. We hope that today's witnesses can help us understand what flaws may exist and how they contributed to the Enron crisis.

• But before we jump into possible legislative solutions, many of which could have a detrimental affect on worker retirement plans, we must take the time to allow investigators to report their findings. We need to know how our system failed before we can fix it without doing possibly more damage. Let us remember that these investigations are only a few weeks into their work and that the complexity of the record-keeping at Enron took all the lawyers on Wall Street years to decipher.

• We must also remember that millions of Americans are participating in retirement plans and reaping enormous benefit from them. The success of private pension plans has transformed worker retirement in America. Today, because of these plans, the majority of retirees can experience the comfortable retirement that was once available only to the very well to do.

• Last weekend I met with a company in Arkansas which has provided an extremely successful Employee Stock Ownership Program since 1975. Almost one thousand employees and retirees are benefiting from the program. They wanted to meet with me out of concern that we in Washington would seize on a political issue and pass laws preventing their kind of plan.

• And, of course, my home state of Arkansas has many stories of employees who have made substantial retirement nest eggs through their companies 401(k).

• We must get to the bottom of the Enron issue, but we must make sure that we preserve the best parts of our private retirement system. One of these is the ability of individuals to make their own choices, based on their own situation, when investing for retirement. The President has submitted a plan which not only preserves this right, it enhances it. Under the President's proposal, workers could no longer be locked into a portfolio filled with company stock. Rather, employees would be allowed to sell company stock and diversify into other investment options once they have participated in a 401(k) plan for three years.

• Workers need to be empowered to make choices and to get the best information possible when investing. Our current laws intended to protect workers retirement funds actually prevent them from obtaining affordable financial advice. I would support amending this law to allow employers to provide their workers with access to professional investment advice as long as the advisers fully disclose any fees or potential conflicts to the plan participants and strict safeguards are in place to ensure that workers receive advice solely in their best interests.

• Today I hope to focus on what went wrong at Enron, what the Department of Labor is doing and can do to help those injured employees, and who will be held responsible for this failure. If reforms are needed in the system, I hope this committee will fully debate the issues, gather information from the experts and fully explore legislative remedies. I want to thank Secretary Chao for coming to testifying here today, as well as all of the panel members. I look forward to your testimony. Thank you Mr. Chairman.

The CHAIRMAN. Our first panel includes Senator Barbara Boxer, Senator Jon Corzine, and Representative Ken Bentsen. We will hear first from Senator Boxer and Senator Corzine and then from the Congressman.

Senator Boxer has a long history of working to find ways to protect workers and their 401(k)'s, and Senator Corzine has a unique experience with the financial markets as the former co-chair and CEO of Goldman Sachs.

They will explain how their bill, The Pension Protection and Diversification Act of 2001, S. 1838, will protect workers by limiting the amount of employer stock each worker may hold and encouraging diversification of investment plan assets. We look forward to hearing from them.

Senator Boxer?

STATEMENTS OF HON. BARBARA BOXER, A U.S. SENATOR FROM CALIFORNIA; HON. JON CORZINE, A U.S. SENATOR FROM NEW JERSEY; AND HON. KEN BENTSEN, A REPRESENTATIVE IN CONGRESS FROM TEXAS

Senator BOXER. Thank you so much, Mr. Chairman, ranking member Gregg, and other members of the committee. It is nice to be here.

Senator Corzine and I are going to divide our testimony. I will be brief in giving an overview, and he will get into the specifics, and then we will answer your questions.

Mr. Chairman, this is an issue—protecting 401(k)'s—that has touched many Americans deeply and profoundly. I personally—and I know that I speak for Senator Corzine, who will put it in his own words—want to give voice to those Americans. We want them to have faith and trust in the future.

Let me give you three quick examples. Edith Thompson has a 401(k) pension plan with $84,000 of employer stock. After employer bankruptcy, her investment was worth $8,000.

Bernice Pines' 401(k) plan held $88,000 in her employer stock. After company bankruptcy, Bernice's investment was worth $9,000.

Woodrow Moose Isaacs lost $57,900 that was in his 401(k); most of that money was in employer stock.

These were not Enron employees. They were employees from Carter Hawley Hale, which went bankrupt in 1991, and from Color Tile, which went bankrupt in 1996. And Senator Gregg, you talked about retail clerks. The two women were retail clerks, grandmas, who worked for The Emporium, which was a wonderful department store owned by Carter Hawley Hale. And when they came to see me, all they said was, "We want to have money to take our grandkids out on the weekend for dinner." Their whole life was about that, and all of that vanished.

So this is not about running before the media. This is not about a one-time problem. This is a problem that has shown up to us very clearly since 1991.

So I think the time has come to do something about it, and of course, I say to Senator Gregg, not to undermine the 401(k) plans, but rather to give them strength and durability.

Less than 2 months ago, the Commerce Committee on which I serve heard from an Enron employee, Ms. Janice Farmer, who had built up $700,000 in her 401(k) plan. She saw it plummet to $20,000. This is what she told the committee: "Sometimes at night, I do feel real bitter over what I have lost, because it was a big part

of my future, and I do not know how I am going to handle the future now. All I can do is hope and pray that I do not get sick."

So it has been tragic, and I know that we have all heard these voices, and we have all seen these faces.

In 1996, I wrote The 401(k) Pension Protection Act. It called for a 10 percent limit in company assets across individual plans. It was pummeled. It was pummeled. If I might say, every economic interest came forward and said it was a bad idea.

Eventually, we did get it passed in a very watered-down fashion in The Taxpayer Relief Act of 1997, which in its final version as it was accepted said that an employer cannot force an employee to spend that employee's money on more than 10 percent of employer stock. That was weak, and it did not serve to save anybody here.

So I can truly say that if my bill had passed—and I am not sure it was perfect, and we could have compromised it to 20 percent or 30 percent or 40 percent of employer stock—we would not have these Enron people in the position they are in. That is all I could say.

So now I am privileged to be working with Senator Corzine, who has so much experience in the business end of the financial world. I was a stockbroker in the 1960's. He was an investment banker in recent years. I had small, individual clients. His career was far different. But having both worked in the financial world, we both feel in our hearts and know in our minds this lesson: Never put all your eggs in one basket, especially in a retirement account where, if something goes wrong, you simply do not have the time to rebuild your retirement, your hopes, and your dreams.

This is our guiding principle: Any bill worthy of our support must prevent another Color Tile, another Carter Hawley Hale, another Enron; otherwise, what is the point?

Humbly, we think our bill does it. There may be other bills that do it which we will support as well.

Let me just show you quickly a chart that shows you that limits on retirement plans are not new. They have been in effect since 1974, Mr. Chairman, and you were on this committee when you supported, as did every Member of the Senate and the House is my understanding, a 10 percent limit on defined benefit plans. We just show you the language, and I will not take the time to read it. But there it is. It is set in stone. It has been there since 1974, and it has worked very, very well.

The point is that we want diversification because we know that that means your risk is limited—and after all, when you are dealing with retirees, you are dealing with a group of people who do not have time to recover. That is the major point.

So we do not think that this is so controversial. It was not controversial 30 years ago. Ours is a 20 percent limit. We do not think it is controversial today.

So again, the message from us is that a cap on company assets is consistent with sound, time-tested financial principles, and it will stop another Enron from happening, and it will protect American workers and their retirement.

Now it is my privilege to turn to Senator Corzine.

Senator CORZINE. Thank you, Senator Boxer, Mr. Chairman, and ranking member Gregg, and to my colleagues, thank you for this

opportunity to talk about something that I care deeply about and think I may be able to add some insights on.

This is really about a simple principle of protecting Americans' retirement savings through a simple principle that everyone that I know in the world that I came from for 30 years bought into—diversification. Lack of diversification in 401(k) plans was the problem revealed by the Enron debacle as it relates to the 401(k) issue, and that is what our Pension Protection and Diversification Act addresses.

The importance of diversifying one's portfolio, Mr. Chairman, is a fundamental principle of finance. Virtually every professional advisor, money manager, or student of finance that I have ever bumped up against speaks about it. Nobel Prizes have been awarded to those who have advocated this principle—I worked with one of them, Fisher Black, at Goldman Sachs—and a whole series of folks who have argued over and over about the value of diversification.

No company, no matter how established or how successful, is assured of eternal or continued success. Last year alone, 255 of roughly 3,000 public companies filed for bankruptcy—big ones, small ones, all kinds of companies. And by the way, it is not just an issue of bankruptcy. Volatility and price performance of the stock is just as important an issue, as we saw with regard to Lucent, in protecting retirees' pension plans.

We live in an uncertain world. It is an uncertain world, and it makes no sense to invest too great a portion of one asset in a single company, particularly when we are talking about retirement saving. That is why we limit even sophisticated financial participants like banks to lend no more than 10 percent of their capital in surplus to one company. We think it is in the public interest to make sure that we do not have over-concentrations in sophisticated financial institutions. The same really goes for securities firms and insurance companies. If we believe that such diversification requirements are appropriate for sophisticated financial firms, for the life of me, I do not think I can understand why we leave ordinary investors exposed to such inordinate risk.

We just had 2 days of hearings on financial literacy in the Banking Committee, where we heard witness after witness, fact after fact, about the poor State of financial literacy in this country. I encourage the members of the committee to review some of that data.

In addition, the risks of concentrating assets in one company are substantially magnified for the people who work at a company. It is bad enough to lose your job, but it is worse if you lose your retirement savings at the same time, and it can be devastating, as we saw with a number of the folks at Enron.

This is something, though, that does not have to go to bankruptcy to have those kinds of problems occur. The chairman mentioned Lucent, which is from my home State. Actually, the price over 18 months went from $85 to $6, and we have numbers of cases where market loss as opposed to just bankruptcy or fraud or whatever have caused these problems.

Ultimately, Mr. Chairman, Enron is not the only company in which employees have invested large portions of assets. I think many of you have seen this chart. The chart shows how pervasive

this problem is even among some of America's most respected businesses. At different points in time, they all look like good investments, but prices go up and down as markets change through time.

And in fact, Mr. Chairman, for companies with 5,000 or more employees—and I want to stress this—this is really a large company problem as opposed to a small business problem—company stocks account for 43 percent of total retirement assets for companies with 5,000 employees or more. I do not know of a single portfolio advisor, financial advisor, who would tell anybody to have 43 percent of their portfolio in one stock. In this case, we see from 94 percent down to 63, and Enron was the best of the lot here, at 57, and this is a rank ordering.

Mr. Chairman, in the past, Congress has recognized this broad interest, as Senator Boxer talked about. ERISA rules were at 10 percent. That passed unanimously in the Senate and the House. But we developed a loophole as it relates to 401(k)'s, and that puts at risk the retirement security of millions of Americans, 42 million exactly, in the 401(k) programs.

The bill that Senator Boxer and I propose eliminates at least a part of that special exemption for 401(k)'s and narrows its scope, and we put a 20 percent limit with respect to company-held stock for employers. By the way, we do not apply this to stocks that are already—there will be transition rules—it is only to the investments in company stock, and it does not go at building up wealth. I am a big fan of 401(k)'s and the kinds of defined contribution plans that are in place across this country. Mr. Chairman, a 20 percent diversification requirement would have prevented—would have prevented—the kinds of human tragedies we have seen among Enron employees. And I think that is the question you have to ask—how are we going to get at stopping or preventing the kinds of problems it came from?

The Federal Government has had a longstanding role in protecting investment programs. This is not a paternalistic program. We should let people invest as they want with their own private moneys. There is nothing that we are arguing that is different than that. But there is a difference with retirement moneys. When many workers come to invest in company stock, they go into meetings, and there is both implicit and explicit pressure to invest in their company. Employees are enticed by well-intentioned employer matches to bias their commitments, biases that are substantially underwritten by tax subsidies by the public.

Second and perhaps most important, if an individual wants to invest in his own company or the employer wants to encourage it, there are other ways to do that—stock purchase programs, options, or just outright investment. No one is telling anyone how to invest his or her own money. We are talking about tax-subsidized retirement programs. And by the way, those tax subsidies are very real. We have seen estimates of $60 billion a year to $90 billion a year, and the President's budget this year alone said there was $330 billion over the next 5 years. It is in the President's budget. That is more than we spent last year on our entire defense budget. So it is a substantial taxpayer subsidization that is involved in creating the kinds of biases that we see in the programs.

Mr. Chairman, let me make it clear that I believe subsidizing savings to promote retirement is a good thing. I am not arguing that we should not be in defined contribution plans. We just should not be subsidizing risky investment strategies. It bears repeating that if people want to risk all of their investment dollars by placing all their investments in the employer, that is fine—with their own money—but they should not do it on the dime of the taxpayer, as we are subsidizing through our 401(k) programs.

Mr. Chairman, remember that when individuals make risky investment retirement bets, social costs go up as well as the tax subsidies. We will end up with charity care, Medicaid, and other kinds of support programs when people do not have adequate retirement. So I think it is important that we think about this in a comprehensive context, not just simply with those $330 billion of tax subsidies.

Let me also respond to the claim that if our bill is enacted, fewer companies will contribute to the employees' 401(k). We have heard this doomsday scenario, and it tries to scare people away from the thought. The fact is you have cash matches as well as stock matches, and employers get the same tax deduction, the same tax treatment, the same reporting treatment for cash matches as they do with their employer stock. What they are really interested in is the free cash flow—I will get into the detail of that at some other time. But this is not about how a company is going to be treated.

And probably most important, employers want to maintain meaningful retirement plans because of competitive pressures in the marketplace. If you do not offer a 401(k), and other companies do, you will not be able to hire the best employees, retain them, and motivate them—and that is what this is all about in a competitive labor market. I think it is important that we not lose track of the fact that there is more likelihood in my view that if these 401(k)'s are properly managed, properly structured, you will get more employers offering and, more important, you will get more employees participating in them, because we do not have the kinds of problems that we saw at Enron, Lucent, or a whole series of other employers.

This is not hyperbole. This is just sound investment management practice.

To sum up, Mr. Chairman, Congress' top priority should be to protect the retirement security of ordinary workers. To do that, we must close this loophole which allows 401(k)'s to be concentrated, as we are suggesting here, to ensure that no taxpayer is forced to subsidize gambling on risky investments, but most important, to prevent the type of personal tragedies that we saw at Enron and many other companies.

Mr. Chairman, retirement security in America can be a lot better. It has some effective points, but it could be a lot better. We need to reform our system. I think the President has made some positive first steps. I think our bill will do more to make sure that we do not have another Enron. We support the idea of flexibility. We like the idea of making sure that financial advice can be given to employees—independent financial advice. We like the initiatives with regard to lockdowns. But if we do not deal with the fundamental principle of diversification, we will not have solved the

problem that existed at Enron, we will not have solved the problem that occurs with companies that have changed financial conditions, whether bankrupt, bad business plans, or market volatility.

I think the key question that all of us have to ask when we look at this question is: Would this reform have protected the retirement savings of Enron employees? Would it protect the savings of some of these companies that have 75 percent? Unless we can answer that question in the affirmative, I do not think we have really dealt with reform.

I thank you for your attention.

The CHAIRMAN. Thank you.

That was an excellent and very compelling presentation. Usually, we do not ask our Senate colleagues questions, but I just want to ask a quick one of Senator Corzine. You mentioned that the defined benefit program is limited to 10 percent. As I understand it, mutual funds are limited to 5 percent. At Goldman Sachs, J.P. Morgan, Lehman, and the principal financial investment houses of this country, is there a limitation in that respect?

Senator CORZINE. I think, Mr. Chairman, you are talking about what individual companies would put on rules inside their own companies for diversification.

The CHAIRMAN. Yes.

Senator CORZINE. I happen to be a trustee to a foundation at a major university in this country, and we have a 3 percent limit. These are—not myself, but others—sophisticated financial folks who look at diversification and putting caps that will spread out the risks that are associated with investing, so that if one particular asset goes down, you have a good opportunity to have other assets doing well.

The CHAIRMAN. Let me ask you a final question. How do you respond to the statement that this is denying the freedom of individuals to be able to make choices about their own retirement?

Senator CORZINE. Mr. Chairman, if an individual wants to invest, no one is telling him how to invest. But when we have $330 billion, as the President has indicated in his budget, supporting 401(k) pension programs, I think the public has a right to say that we ought to do that in conformity with sound investment principles.

The CHAIRMAN. Senator Gregg?

Senator GREGG. Following up on that thought, are you saying that the employees at Abbott Labs, Pfizer, Anheuser Busch, Coca-Cola, General Electric, Texas Instruments, Williams, McDonald's, Home Depot, Duke Energy, Textron, Kroeger, and Target are suffering and are being ill-treated by their corporations?

Senator CORZINE. I think they are put at risk that they might not fully appreciate. If you went back to 1997, 1998, or 1999 and asked employees at Enron if they were exposed to the kinds of risk that they thought they were going to be exposed to—or at Lucent, which was not a case of potential misinformation or fraudulent reporting practices—you would find people saying that these are great companies. A number of those companies, by the way, in the last 3 years or 5 years, have lost value in their stock net on net. Some of them have, some of them have not. We could give you that information.

Senator GREGG. I would like to find a company in the last 3 years that has not lost value in its stock. I guess my point here is why shouldn't the employee, once his stock is vested, once he has reached the vesting requirements—and the date of vesting is I think a very legitimate issue in this debate—but once it is vested, why shouldn't the employee have the opportunity to continue to accumulate, instead of being told that they can only accumulate 20 percent?

Senator CORZINE. Because when the American public is putting as much investment into these programs, which we are through tax subsidies both for the employee and for the employer, I think we have reason to ask, just as we did with ERISA, to have sound financial principles, diversification principles, followed in how people's retirement savings are managed.

Senator GREGG. Isn't the subsidy here that you talk about—which is significant, there is no question about that—isn't that subsidy one of the driving forces that causes corporations to want to use its stock to incentivize its employees to expand their retirement? In other words, one reason they are putting stock in instead of cash—and we can go through that, as you said, but it may take a while—one reason they are putting stock in instead of cash is because there are significant tax advantages to them which they use to benefit their employees. I mean, the end result of this $330 billion number that you are using is not that it is coming out of the taxpayers' pockets, which it is—the end result is that it is ending up going into the employees' pockets in the form of an expansion of their ownership in stock in companies. And I guess it gets back to my question, which is——

Senator CORZINE. Senator, that is great as long as that value holds over a 30-year period, but anybody who follows stock prices over a period of time, even for many of these great companies, knows that those prices go up and down substantially over a long period of time.

Senator GREGG. But why do you feel that you should say to someone in a company—let us take Wal-Mart as an example—you do not have Wal-Mart up there—let us take Abbott Labs as an example. Somebody has worked for Abbott Labs for 30 years. They have a vested plan, so they have the right to sell that stock if they want to. And every year, they get more of that stock, but they have decided as part of their retirement structure that they do not want to sell the stock because they like the company they work for. Why should we arbitrarily say to them that you have got to sell the stock no matter what you do? Even if you are working for this company, and you like the company, and you see the future of this company, and you know that you are going to retire with a million, possibly multiple millions, even though you are just working on the line for these people, you have still got to sell that stock and buy something else which may go up or down. It is not just that company that might go up and down; whatever they invest in might go up and down.

Senator CORZINE. You are challenging the whole principle of diversification, Senator Gregg, because the idea of——

Senator GREGG. What I am challenging is the principle of why we as a Congress should arbitrarily demand diversification, why

we should not allow the employee who has the vested asset to make that decision versus our arbitrarily saying "You must diversify."

Senator CORZINE. Diversification is accepted by anyone that I know in the financial services industry or academia or any other place that people talk about investments as a principle that both reduces risk and improves performance. People have won Nobel Prizes proving that.

Senator GREGG. I appreciate——

Senator CORZINE. But the point is that the American public is spending $330 billion over the next 5 years, according to at least this information in the budget——

Senator GREGG. To expand retirement benefits.

Senator CORZINE [continuing]. To expand retirement. Why should we be encouraging behavior that is contrary to the fundamental principle of sound investment?

Senator GREGG. Well, I thought one principle of investment was that you allowed the investor to make the decision.

Senator CORZINE. We are not telling investors what to do with their own money.

Senator GREGG. This is their money. Once it is vested, it is their asset. They can make the decision or not.

Senator CORZINE. We are not telling investors in retirement programs which are sponsored by the Federal Government how to invest outside of——

Senator GREGG. Yes, you are. You are saying they cannot invest in the company they work for over 20 percent.

Senator CORZINE. We are saying that we should be following sound principles——

Senator GREGG. No. You are telling them you cannot own more than 20 percent of the company that you work for, even though you have the option of owning it under your present plan.

Senator CORZINE. They have plenty of opportunity in stock bonuses, option plans, and other things where they can invest in the company.

Senator GREGG. Well, maybe they do not, maybe they do not. What about if they only have an ESOP?

Senator CORZINE. Well, this deals with 401(k)'s, as you know.

Senator GREGG. Well, how do you make this argument with an ESOP?

Senator CORZINE. In fact, I think many of the ESOPs are too concentrated. We dealt with the 401(k) problem that is the problem at Enron. Circumstances change, and I think that when the public is making the kind of investment that we are making in encouraging the retirement savings, we have a right to say that we ought to follow sound financial principles.

You could not find a financial advisor to sit here and recommend to anyone that they should have 64 percent or 75 percent or 94 percent of their stock.

Senator BOXER. May I respond very quickly to this point?

The CHAIRMAN. Yes.

Senator BOXER. If you look at your own plan, Senator, as I have looked at ours here in the Federal Government, we have a good plan here. We have a thrift savings that is like a 401(k) in addition

to our defined benefit plan—or at least some of us do; if you are in the old system, you do not have that opportunity—but a lot of us are on that, and a lot of our employees are. We do not say that you can take all that money and put it in one stock. You have options. You can either put it in the——

Senator GREGG. That is because we cannot buy stock in the Federal Government.

Senator BOXER [continuing]. If I could finish, sir—you either put it in the C Fund, you put it in the F Fund, you put it in the G Fund. A lot of companies do that, and they do it very well.

I think the important point for us to consider here is why not make sure that the people who are in these funds have the security that we have. And I will say this——

Senator GREGG. Well, if they worked for the Federal Government, it would be little different, Senator.

Senator BOXER [continuing]. And I will say this—and why not make sure that the people, the hard-working people who come before this committee I am sure and come before ours, and you see the look in their faces, the stunned look in their faces, have that basic sense that the same principles that apply to the hotshots on Wall Street and their firms, and the biggest foundations in the country, that in fact we are out there saying we are going to have those sound principles in the 401(k)'s. We did it in ERISA for the defined benefit. I never heard you or any other Senator try to change that rule. Maybe you are going to change it. There, you are only allowed 10 percent of the company's money in those defined benefit plans.

Senator GREGG. Well, of course, as the Senator knows, the defined benefit plan is significantly different from a defined contribution plan.

Senator BOXER. In any event, I hope you will consider these facts.

The CHAIRMAN. Senator Dodd?

Senator DODD. I will just thank the chairman, and obviously, we will get into this in some length—and I will ask unanimous consent to have a statement included in the record—but I am just curious in following this point. I met with a couple of CEOs the other day who were talking about this issue, and one of them suggested that rather than putting a cap percentage-wise, the idea would be that if you allowed—or, insisted, rather, not allowed, but insisted—that these benefit plans and their investments be made independently so that there would be a requirement that the employees would deal with outside independent investors rather than the pressures, Jon, that you talked about that are inherent here, implicit or otherwise, that you plow these resources back into the company.

I am just curious about your view of that as a way of—I do not think anyone would recommend, as you point out, that someone have 30, 40, 50 percent of their retirement tied up in a single stock, whether it is their own company's or someone else's; I do not think you would last very long—but the idea of having independent advisors advising employees about where their retirement funds ought to be located. I might not be articulating that as well as I can, but do you understand the point I am making?

Senator CORZINE. I certainly believe that independent financial advisor elements, which I think there is a general consensus——

Senator DODD. Does that exist today? Does that happen?

Senator CORZINE. It does with some companies. It is not mandatory, and often, it is just a sheet of paper, and you check off whatever you are going to have, and often it is done with employers presenting the case of how effective the company is. So I think there are enormous built-in explicit and implicit biases that encourage employees to do the matches, and it is definitely to the advantage of the employer to have the cash flow and the reported earnings format that comes from employees putting their stock in the 401(k) of the employer.

[The prepared statement of Senator Dodd follows:]

PREPARED STATEMENT OF SENATOR DODD

Good morning. Thank you Mr. Chairman for calling this important hearing. Details of the Enron collapse are intricate and complex. Senior executives, board of directors, accountants, and hidden subsidiaries are at its core. The essence of this failure amounts and appears to be the gross negligence of the people who ran the company and the people they hired to help run the company. They spun a web of deceit.

Thousands of Enron employees dedicated their lives to the company. They believed in their employer's leadership and honesty. During the last couple of months I have heard various accounts of employees who have worked for Enron for more than 20 years. They spoke of how happy they were to be a part of the Enron team, how they believed in who they were working for. And from one month to the next, these sentiments were shattered.

The leaders of this company told their employees that the company was sound and strong even while they were being confronted with the reality that the company was heading towards bankruptcy. They insisted to the rank and file employees that everything was fine, and that the company stocks would return to an upward trajectory. They said this even though most senior executives of the company had in their possession a memo from Sherron Watkins, an Enron Vice President, warning that questionable accounting practices could bring about the Company's downfall. Once they realized that their foundation was starting to give way, when bankruptcy was a very big possibility, they said nothing and did nothing to protect their employees. When the truth finally did come out, the hard working employees at Enron were deserted, and their financial futures shipwrecked. Since 1997 Enron overstated its earnings by $567 million, so it should not be surprising that the employees thought their retirement savings were secure at Enron.

I don't know what will be done for them, their only true remedy is in the courts, but we have an obligation as the law making body of this nation to make sure that pensions and retirement funds are protected from wrong doings. Many of the laws governing employee pensions today were enacted more than 25 years ago at a time when workers had much less control over their retirement savings. Congress has an obligation to identify any problems in the law that may have contributed to this deplorable situation.

Our colleagues in the Senate and the House have submitted a number of constructive proposals, and I look forward to learning more about them. I note that Secretary Chao is also here to talk about the pension system and the Administration's ideas. It is an honor to have you with us Madame Secretary. I would also like to take this time to welcome the employees and former employees of Enron and the pension experts. I look forward to hearing all of your testimony, so that we can move forward in taking action to protect our retirement savings system. Thank you.

The CHAIRMAN. I want to thank our two colleagues very much, and we look forward to hearing now from Congressman Bentsen—yes, Senator Wellstone.

Senator WELLSTONE. Mr. Chairman, before we hear from the Congressman, I just want to be clear that a number of us would love to get into this discussion, and we thank you for being here. We just know that we have many more people who are going to testify.

Senator BOXER. Well, we will talk.

Senator WELLSTONE. We will talk. Thank you.

Senator DODD. Let me just say, too, Mr. Chairman, in all candor—and we welcome you, Congressman, as well over here on the Senate side—but I just want to say what a pleasure it is to have Jon Corzine, who does bring—we all come from different backgrounds—but to have someone who comes out of the investment community as a background is tremendously helpful. On the Banking Committee, Senator Corzine and I are working on a number of different ideas as well, but it is tremendously helpful to have your background and knowledge. You bring real value to this debate and discussion in the Senate.

Senator GREGG. And it is a pleasure to have Senator Boxer.

The CHAIRMAN. Here we go down the line.

Senator BOXER. Thank you, Judd.

Senator WELLSTONE. And Senator Dodd and Senator Kennedy, for the record, actually, a long time ago, I taught Senator Corzine everything he knows about the financial world. I just want that to be clear.

[Laughter.]

The CHAIRMAN. Thank you very much.

Congressman Bentsen, we are glad to have you, too. We know that you represent so many of those who have been affected by this in the district, so welcome.

We are going to have a vote in just a few moments in any event, so we will excuse our colleagues, who are always welcome, and recognize the Congressman.

Senator BOXER. Thank you.

Senator CORZINE. Thank you.

Mr. BENTSEN. Thank you, Mr. Chairman, Senator Gregg, and members of the committee.

First of all, let me thank you for having this hearing and also let me thank you for allowing me to testify and give you a couple of ideas I have in response to the Enron debacle.

I would say at the outset that there was discussion of ERISA, which passed in 1974, and I think ERISA came about in 1974 in part because of abuses that were occurring with respect to employ-

ees under the old pension scheme at the time. And I think if you go back to the 1930's, when Congress passed the Securities and Exchange Act and the Investment Company Act and the Glass-Stiegel Act, FDR at the time talked about the need to level the playing field for all investors. And I think coming out of Enron we also see a similar situation right now.

I think you have to be from Houston, TX to understand just how devastating this is to our community and to the thousands of employees who have not only lost their jobs from a company that they put their hearts and souls into, but have lost their savings and their life's dreams.

Over the last few weeks, I have met with a number of former employees—in fact in anticipation of the former CEO Ken Lay testifying before one of the committees I sit on in the House, I met with a number of them last week—and over and over again, you heard these employees say "We trusted them." But I think that in this last week, that trust has truly been tested, and as they look at what is left of their savings, there is not much left in trust there as well.

As one who has endeavored to expand greater pension savings, I am outraged by what happened to Enron with respect to its employees and their savings, particularly when we see that executives were bailing out with golden parachutes, and rank-and-file employees were locked into holding a worthless stock and watching it drop when they could not get out.

Last week, I was contacted by an Enron retiree, Charles Presswood, who I believe is going to testify before this committee. For 33½ years, he worked in the field as a pipeline operator. On October 1, 2000, he retired with over $1 million in his employee stock ownership plan. He planned to travel the world and see places he had never been to before, but found that because of the irresponsible if not criminal acts of the mangers and directors at Enron, he was robbed of that retirement. Now he has to figure out how to make ends meet on Social Security and what is left of his small pension.

When asked why he held so much company stock in his account, Mr. Presswood explained that: "When you are in the home stretch of a race, and your horse has been six lengths ahead from the start, why switch horses?" Why indeed. But that was certainly the sentiment of many employees.

In early October, when they did want to get out of this stock like other investors were doing, they were blocked from doing so. Enron closed employee retiree accounts packed with stock, and shares plummeted in late October and early November.

When all was said and done, Enron Corporation's 401(k) plan lost about $1 billion in value. During this lockdown, Enron employees could only watch in horror as their company stock fell from $30.72 cents per share at the close of trading on October 16 to $11.69 a share on November 19.

Many employees complained that notice was given internally over the company's email. Mr. Presswood, who was no longer on the internal company network because he was a retiree, received a letter dated October 8, postmarked October 10, notifying him of the October 16 lockdown—clearly insufficient notice.

I have introduced one piece of legislation, H.R. 3509, in the House, The Retirement Account Protection Act, which would prevent employers from unilaterally issuing a lockdown of company stock sales and enhancing notice requirements for such action. Under my bill, employers could only proceed with a lockdown at the explicit direction of the Secretary of Labor.

I have spent a little bit of time around the financial markets—nothing like the Senator—but the fact is that I cannot think of any instance where an institutional investor would have their assets and would be precluded from trading in and out of their assets and certainly not with the fiduciary taking some financial responsibility to hold them harmless. But under current pension law, fiduciaries are able to freeze accounts, and employees are the ones left holding the bag.

I think the Senator would agree, as one who has been in the markets, that we have the financial technology available today in order to switch accounts and switch benefit managers so as not to have to lock someone out for 2 weeks.

I would also say to the committee that this is not something unique to Enron. We just read that Global Crossing, another company which has gone into bankruptcy, had a similar lockdown period over this time.

We could pass this bill this year and stop what I believe is, if not an abusive practice, certainly an outmoded and outdated practice.

There is another issue that I think is terribly important, and that has to do with the legal status of employees and their 401(k) accounts, because under the current Bankruptcy Code, employees with 401(k) accounts that lose value have no priority status. This is true even if they can prove that they were knowingly misled by the fiduciary. And as the result of a 1999 Federal District Court decision in Montana dealing with the bankruptcy of Morrison Knudsen, Morrison Knudsen was able to extinguish any claims from the 401(k) holders as they emerged from bankruptcy, but even given the fact that the employees were asserting the claim that they were knowingly misled as to the financial condition. We should not allow this to go forward.

In the case of Enron, I have heard from numerous employees, as I think most members of this committee have, who were told repeatedly—repeatedly—that the company's prospects were never better. They were told that the stock was undervalued. An email that was sent out at the end of August granting new stock options to employees from Mr. Lay, the CEO at the time, who had come back after Skilling had left, said: "One of my highest priorities is to restore investor confidence in Enron. This should result in a significantly higher stock price." This is from the fellow who put the company together in the first place. And throughout all that time—in fact, I think on September 26, it was stated that the stock's future was never better—but throughout all that time, Mr. Lay and others were selling their stock back to the company and in effect getting out of it.

You heard testimony in the Senate yesterday from the benefits manager, who said that she was notified in August that there were potential problems, and we have heard other discussions from folks

who say that deferred compensation plans were drained by current employees, but not everybody was notified of it.

To me, it seems that there is no question that somebody knew something was going on, but the employees were not let in on this, and as a result, they lost their savings. They deserve to have their day in court. They deserve to have a seat at the bankruptcy table.

My bill would allow employees to assert a claim under the Bankruptcy Code that they were knowingly misled. If they could achieve that claim, they would receive priority status in the same way that employees would for back wages. It seems only fair, particularly in a situation where the employees are the ones who are supposed to determine how to invest their accounts under a defined contribution plan that is different from a defined benefits plan, that they ought to have some rights.

So I would ask the committee to consider as you move forward—and I hope you move forward on some pension reform legislation—to consider these types of rights, because quite frankly, we do need to level the playing field so that employees are treated the same as any other investor in the marketplace.

I think the Senator would agree, because we have both been around a number of institutional investors and other types of investors, that they would not stand 1 day for the type of treatment that employees are given under 401(k) plans.

Senator DODD. Quickly—because we have a vote on here, and I heard your beeper go off as well, so there may be a vote in the House—I am curious, Jon, and maybe you can answer this. The President has argued for a 3-month period, and we are going to hear from Elaine Chao shortly. I have heard others suggest that that 3 months is totally unnecessary, that you could have a much shorter period than that amount of time. And Congressman, you pointed out that with the technology today, there is no reason for it.

Are there other reasons that you have a lockdown period that makes some sense that others who have not worked in this field should be aware of?

Senator CORZINE. The only reason that I have heard that folks need this time is that it is administratively impossible to get the assets shifted from one place to another.

Senator DODD. Do you need 3 months? In your view, then, it does not need to be 3 months?

Senator CORZINE. In my view, actually, with technology at the state it is today and the requirements that people have, it could be done in a matter of days.

Mr. BENTSEN. If I might, Senator, two things. One, our bill gives the Secretary the authority—a company can petition the Secretary to get authority if there is a merger going on that would create a problem. But second of all—and I am sure that Senator Corzine has been involved with this—I structured a number of trust accounts and things like that, where flow of funds was terribly important, and had you not been able to hold the investors harmless for risk to their funds, they would not invest.

At the very least, if there has to be a period of time, somebody should hold harmless the employees. The fiduciary should underwrite some of that risk one way or the other. And let me tell you,

if you figure out a way for them to underwrite the risk, they will fix it like that; they will find the computer guy who can make it work.

But we really ought to fix this. I commend the President for saying that during a lockdown period—if I understand his proposal correctly—managers should not be able to sell their stock. Well, what is good for the goose is good for the gander, and we ought to fix that.

Senator DODD. Just quickly—because again, getting a law passed—to what degree does flexibility exist today? We saw the list of various corporations here with significant stock being held by employees. To what extent does the flexibility exist under existing law for a lockdown period to be much briefer than we saw in the Enron case, or even the one suggested by the President?

Mr. BENTSEN. I think you would have to check with counsel, but based upon my counsel, we believe that there really is no law on this, so I do not know whether the Secretary of Labor has authority under ERISA to impose restrictions on this or not.

Senator DODD. OK. I need to make the vote, and Senator Kennedy will return shortly, so we will take a 5-minute recess while we finish the vote and then pick up after that.

I thank both of you, and Ken, thanks immensely, and our best to your constituents in Houston as well.

Mr. BENTSEN. Thank you.

Senator DODD. The committee will stand in recess for 5 minutes.

[Recess.]

The CHAIRMAN. The committee will come to order.

We want to welcome the Secretary of Labor and thank her for joining us this morning on this very important issue. I mentioned to her last evening that just before retiring, I turned on my television to get the news, and there was the Secretary in her appearance for a very long and extended day yesterday on this subject matter. So she is representing the administration and the administration's position, and we want to thank her for her willingness to come up here and appear herself before the committee, and we are grateful to her for that.

We want to thank you very, very much for joining us here today, and we look forward to hearing what you have to say on this subject.

STATEMENT OF HON. ELAINE CHAO, SECRETARY, U.S. DEPARTMENT OF LABOR

Secretary CHAO. May I start?

The CHAIRMAN. Yes.

Secretary CHAO. Good morning, Chairman Kennedy, Senator Gregg, and members of the committee.

I appreciate the opportunity to appear before the committee today to discuss the President's plan to protect workers' retirement security. We are here today not just because a major American corporation is alleged to have engaged in serious financial misconduct, although that is troubling enough, nor are we here today only because the collapse of this company essentially wiped out the hard-earned savings of many of its employees, although that is even worse.

We are here because these developments have threatened the credibility of our private retirement system, and we need to act decisively to restore the shaken trust of America's workers.

I know a little bit about the impact on people when public confidence in an institution starts to erode. Ten years ago, I was brought in by the board of United Way of America to be its new president and CEO at a time of immense upheaval. Public confidence in this venerated institution had plummeted, and contributions had fallen off.

Because of this experience, I knew then, as I know now, that we needed to act quickly and responsibly in this case to restore workers' confidence in the security of their retirement plan.

The truth is a vast majority of businesses are responsible about how they administer their employees' retirement plans. Many companies actually take pride in the fact that their workers stay for years, do well financially, and retire securely. This is not purely altruistic. It is good business to care about your workers and try to keep them by offering attractive, secure retirement packages.

Nevertheless, high-profile corporate bankruptcies have provoked a crisis of confidence among hardworking Americans, and we need to address it.

A recent cover story in Business Week asked this question: "Can you trust anybody anymore?" For the sake of our private, voluntary retirement system, the answer to that question must be yes, and the President's retirement security plan will make that answer yes by giving workers the choice, confidence, and control that they need over their retirement savings, the choice to invest in their savings in a way that benefits and works best for their families and themselves, the confidence in their investment choices that comes from getting reliable and professional financial assistance, and the same degree of control over their investments that any other worker enjoys from the top floor to the shop floor.

Over the last 20 years, there has been a revolution in the way that people plan and save for their retirement. Through 401(k) programs and plans, workers at every income level are being given the right to make their own decisions about their financial future. That right has opened up the potential for a better quality of life for millions of Americans. But like every other increase in freedom, it will also introduce new risk.

The same Enron stock that gave thousands of rank-and-file workers a nest egg beyond their wildest dreams also nearly ruined the retirement savings of many other workers later on.

We believe that one of the keys to reducing such risk is to give people even more rights, not less, to give them more choices rather than take choice away. That is why the President's plan will give workers a right that the employees of Enron did not have, and that is the right to sell company stock contributed by an employer to their 401(k) program after a maximum 3-year period.

For most people, diversification is crucial to reducing risk over the long-term. We will give workers the right to make that choice. After all, it is their money, they earned it, they sacrificed to save it, and they should have the right to decide how to invest it.

For that same reason, Washington should not be allowed to dictate to workers how much company stock they can own. It may be

tempting to go down this route in the wake of recent business failures, but this would actually restrict workers' rights instead of expanding them. It would deny workers the right to make their own decisions with their own money, based on their own families' needs and goals.

Arbitrary restrictions on Americans' financial choices would not be progress and would not necessarily make people's retirement savings any safer. All it would do is turn back the clock.

At the same time, we all know that freedom of choice cannot ensure retirement security all by itself. Workers need to have confidence in the decisions that they make, and that comes from getting reliable and accurate financial information. For this reason, the President's plan will encourage employers to give their workers access to professional financial assistance, just like all the rich people have.

As we know, the last year or so has been tough sledding for the average individual investor, and most people simply do not have the time or the inclination to become experts on managing financial portfolios, even their own. They have jobs to go to, they have children to take care of, they have school activities to support and bills to pay.

Especially in these uncertain economic times, people are in desperate need of help as they try to chart their financial futures. So in the same way that we provide retirement benefits through employers, we could also extend high-quality financial assistance through employers in a way that safeguards the workers who receive these benefits. Just as ERISA currently provides, we would require investment advisors to act solely—solely—in the interest of employees. And my Department will aggressively pursue anyone who violates this sacred trust.

Advisors would also be required to disclose any conflicts of interest they may have and any fees they may earn in recommending particular investments. Employers themselves will be held responsible for choosing an appropriate investment advisor and keeping close watch on the programs for their employees. At the Department of Labor, we are committed to rigorous enforcement of the standards of trust prescribed by law. We are expanding our outreach efforts to let workers know what their rights are, what information they should be getting, and how to raise concerns about self-dealing by financial advisors.

Our response to the recent collapse of Polaroid is a case study of how we can and should defend workers' benefits. We opened an investigation of Polaroid before it even declared bankruptcy, based on complaints received by our regional office. We are investigating every angle to protect workers and their families and pursue any breaches of fiduciary responsibility.

Our benefits advisors immediately reached out to Polaroid employees and retirees to help them understand what their rights are and to get the assistance that they need.

As you know, Mr. Chairman, it is a very, very sad and tough situation, but we will do all that we can to help those who have been harmed, because we recognize that what we do in cases like this will strengthen the confidence of others to prepare for retirement.

Finally, people need to have some assurance of control over their retirement savings regardless of whether they are a senior executive or a rank-and-file worker. They need to have ample opportunity to make investment changes before a blackout period is imposed. They must be guaranteed that their employers will be held to the highest standards of conduct, that employers will act prudently and solely in their interest during blackout periods. And workers have got to be assured that everyone, from the CEO on down, will have to abide by the same set of restrictions.

The President's plan will achieve this by requiring that workers be notified a full 30 days in advance before a blackout period. Our proposal will forbid corporate officers from selling or purchasing any company stock while workers are prohibited from trading in their 401(k) plans during the same blackout period.

We will also amend ERISA to clarify in no uncertain terms the fiduciary responsibilities and accountability of employers during blackout periods.

Taken together, these measures proposed by the President will give workers the choice, confidence and control they need to protect their savings and plan for a decent retirement, the choice to make their own decisions, the confidence that comes from getting good information and accountability, and a level playing field that gives workers control over their retirement savings.

As the President stated in his State of the Union Address: "A good job should lead to security in retirement." We know at the Department of Labor that retirement security is our job. In 2001 alone, we conducted nearly 5,000 employee benefit investigations, obtained 76 indictments and 49 convictions, and recovered $662 million on behalf of aggrieved beneficiaries.

Just like with Polaroid, we were on the ground investigating Enron before it even declared bankruptcy and reaching out to workers who needed help.

Whatever kind of retirement plan an employee may have, whether it be a 401(k) or a corporate or a union pension plan, our goal is to protect all hardworking Americans so they can look to their retirement with confidence and with hope.

Mr. Chairman, thank you so much for giving me the opportunity to address this subject today. We look forward to working with this committee to ensure greater retirement security for all Americans.

[The prepared statement of Secretary Chao follows:]

PREPARED STATEMENT OF ELAINE L. CHAO

Introductory Remarks

Good morning Chairman Kennedy, Ranking Member Gregg, and Members of the Committee. Thank you for inviting me here today to share information about the Department's role in enforcement and regulation under the Employee Retirement Income Security Act (ERISA). Over the past 28 years, ERISA has fostered the growth of a voluntary, employer-based benefits system that provides retirement security to millions of Americans. I am proud to represent the Department, the Pension and Welfare Benefits Administration (PWBA), and its employees, who work diligently to protect the interests of plan participants and support the growth of our private pension and health benefits system.

This Administration is very concerned about the impact of the Enron bankruptcy on its workers and retirees. On November 16, 2001, the Department of Labor began an investigation to determine whether violations of ERISA may have taken place.

The Department also is assisting affected Enron workers, informing them of their rights and options with respect to health and retirement benefits.

The Department also has been working diligently to evaluate current law and regulations, and has consulted extensively with the President's domestic and economic policy teams on how to improve and strengthen the pension system.

Although some reforms are necessary, we should not presume that the private pension system is irreparably "broken." In fact, the private pension system is a great success story. Just two generations ago, a "comfortable retirement" was available to just a privileged few; for many, old age was characterized by poverty and insecurity. Today, thanks to the private pension system that has flourished under ERISA, the majority of American workers and their families can look forward to spending their retirement years in relative comfort. Today, more than 46 million Americans are earning pension benefits on the job. More than $4 trillion is invested in the private pension system. This is, by any measure, a remarkable achievement.

As employers move toward greater use of "'defined contribution" retirement plans, such as 401(k) plans, we must nurture and protect employee choice, confidence and control over their investments. I welcome this opportunity to work with the Health, Education, Labor, and Pensions Committee, and recognize the leadership you provide in protecting workers' pension assets, in raising necessary questions about the Enron situation and similar cases, and formulating policy to strengthen this country's retirement system.

My testimony will describe ERISA's background and regulatory framework; the trend towards greater use of "defined contribution" retirement plans and what that means for employers and employees; the Department's role in enforcing ERISA and providing assistance to employees and their families; the Department's actions regarding the Enron bankruptcy; and the President's Retirement Security Plan to improve our current laws to ensure retirement security for all American workers, retirees and their families.

ERISA

The fiduciary provisions of Title I of ERISA, which are administered by the Labor Department, were enacted to address public concern that funding, vesting and management of plan assets were inadequate. ERISA's enactment was the culmination of a long line of legislative proposals concerned with the labor and tax aspects of employee benefit plans. Since its enactment in 1974, ERISA has been strengthened and amended to meet the changing retirement and health care needs of employees and their families. The Department's Pension and Welfare Benefits Administration is charged with interpreting and enforcing the statute. The Office of the Inspector General also has some criminal enforcement responsibilities regarding certain ERISA covered plans.

Under ERISA, the Department has enforcement and interpretative authority over issues related to pension plan coverage, reporting, disclosure and fiduciary responsibilities of those who handle plan funds. Additionally, the Labor Department regularly works in coordination with other state and federal enforcement agencies including the Internal Revenue Service, Federal Bureau of Investigation, and the Securities and Exchange Commission. Another agency with responsibility for private pensions is the Pension Benefit Guaranty Corporation, which insures defined-benefit pensions.

ERISA focuses on the conduct of persons (fiduciaries) who are responsible for operating pension and welfare benefit plans. Such persons must operate the plans solely in the interests of the participants and beneficiaries. If a fiduciary's conduct fails to meet ERISA's standard, the fiduciary is personally liable for plan losses attributable to such failure.

Trends in Pension Coverage

There are two basic categories of pension plans—defined benefit and defined contribution. Defined benefit plans promise to make payments at retirement that are determined by a specific formula often based on average earnings, years of service, or other factors. In contrast, defined contribution plans use individual accounts that may be funded by employers, employees or both; the benefit level in retirement depends on contribution levels and investment performance.

Over the past 20 years, the employment-based private pension system has been shifting toward defined contribution plans. The number of participants in these plans has grown from nearly 12 million in 1975 to over 58 million in 1998. Over three-fourths of all pension-covered workers are now enrolled in either a primary or supplemental defined contribution plan. Assets held by these plans increased from $74 billion in 1975 to over $2 trillion today.

Most of the new pension coverage has been in defined contribution plans. Nearly all new businesses establishing pension plans are choosing to adopt defined contribution plans, specifically 401(k) plans. In addition, many large employers with existing defined benefit plans have adopted 401(k)s and other types of defined contribution plans to provide supplemental benefits to their workers.

Most workers whose 401(k) plans are invested heavily in company stock have at least one other pension plan sponsored by their employer. Just 10 percent of all company stock held by large 401(k) plans (plans with 100 or more participants) was held by stand-alone plans in 1996; the other 90 percent was held by 401(k) plans that operate alongside other pension plans, such as defined benefit plans covering the same workers.

Although there has been a shift to defined contribution plans, defined benefit plans remain a vital component of our retirement system. Under defined benefit plans, workers are assured of a predictable benefit upon retirement that does not vary with investment results.

The trends in the pension system are a reflection of fundamental changes in the economy as well as the current preferences of workers and employers. The movement from a manufacturing-based to a service-based economy, the growth in the number of families with two wage earners, the increase in the number of part-time and temporary workers in the economy, and the increased mobility of workers has led to the growing popularity of defined contribution plans.

Employers' views have similarly changed. Increased competition and economic volatility have made it much more difficult to undertake the long-term financial commitment necessary for a defined benefit pension plan. Many employers perceive defined contribution plans to be advantageous while workers have also embraced the idea of having more direct control over the amount of contributions to make and how to invest their pension accounts.

Emerging trends in defined contribution plans and workers' job mobility make it increasingly important that participants receive timely and complete information about employment-based pension and welfare benefit plans in order to make sound retirement and health planning decisions.

Employer Securities Under ERISA

The investment of pension funds in the securities of a sponsoring employer is specifically addressed by ERISA. ERISA generally requires that pension plan assets be managed prudently and that portfolios be diversified in order to limit the possibility of large losses. Indeed, under ERISA, traditional "defined benefit" pension plans are generally allowed to invest no more than 10 percent of their assets in employer securities and real property. However, ERISA includes specific provisions that permit individual account plans like 401(k) plans to hold large investments in employer securities and real property, with few limitations.

As a separate matter, employee stock ownership plans (ESOPs) are eligible individual account plans that are designed to invest primarily in qualifying employer securities. Congress also has provided a number of tax advantages that encourage employers to establish ESOPs. By statutory design, ESOPs are intended to promote worker ownership of their employer with the goal of aligning worker and employer interests. They are statutorily required to hold at least 50 percent of their assets in employer stock. On average, ESOPs held approximately 60 percent in employer securities in 1996.

The legislative history of ERISA provides us with some of the rationale behind these exceptions to the rules regarding diversification. First, Congress viewed individual account plans as having a different purpose from defined benefit plans. Also, Congress noted that these plans had traditionally invested in employer securities.

In 1997, Congress amended ERISA to limit the extent to which a 401(k) plan can require workers to invest their contributions in employer stock. The rule generally limits the maximum that an employee can be required to invest in employer securities to 10 percent. The rule, however, does not limit the ability of workers to voluntarily invest in employer stock. Furthermore, the rule does not apply to employer matching contributions of employer stock or ESOPs.

Recent data indicates that 401(k) plans holding significant percentages of assets in employer securities tend to be very large, though few in number. Currently, almost 19 percent of all 401(k) assets, or about $380 billion, is invested in company stock. The distribution of holdings of employer securities is very uneven, however, with most 401(k) plans holding very small amounts or no employer stock. Fewer than 300 large plans (those with 100 or more participants), or just one percent of all 401(k) plans, invested 50 percent or more in company stock in 1996.

Because the plans heavily invested in company stock tend to be very large (with an average of 21,000 participants), the number of workers affected and the amount

of money involved are substantial. In 1996, just 157 plans held $100 million or more in company stock. Together, these plans covered 3.3 million participants, and held $61 billion in company stock.

A great deal of the 401(k) money invested in company stock is under the control of workers. When participants can choose how to invest their entire account and company stock is an option, participants invest 22 percent of assets overall in company stock. However, when employers mandate 401(k) plan investments into employer stock, workers choose to direct higher portions of the funds they control into employer stock. In these plans, participants direct 33 percent of the assets they control into company stock.

If a 401(k) plan provides workers with the right to direct their account investments, and the plan is determined to have complied with section 404(c) of ERISA, then plan fiduciaries are relieved of liability regarding the consequences of participants' investment choices. The Department's Section 404(c) regulations are designed to ensure that workers have meaningful control of their investments. Among other things, employees must be able to direct their investments among a broad range of alternatives, with a reasonable frequency, and must receive information concerning their investment alternatives.

PWBA Actions: Immediate Response to Enron

We are bringing to bear our full authority under the law to provide assistance to workers affected by situations such as the recent Enron bankruptcy.

The Department of Labor has made a concerted effort to respond rapidly to situations such as Enron. In these circumstances, there are two aspects to our efforts: to help the workers whose benefits may be placed at risk and to conduct an investigation to determine whether there has been any violation of the law.

On November 16, 2001, over two weeks before Enron declared bankruptcy, the Department launched an investigation into the activities of Enron's pension plans. Our investigation is fact intensive with our investigators conducting document searches and interviews. The investigation is examining the full range of relevant issues to determine whether violations of ERISA occurred, including Enrons treatment of their recent blackout period.

Blackout periods routinely occur when plans change service providers or when companies merge. Such periods are intended to ensure that account balances and participant information are transferred accurately. Blackout periods will vary in length depending on the condition of the records, the size of the plan, and number of investment options. While there are no specific ERISA rules governing blackout periods, plan fiduciaries are obliged to be prudent in designing and implementing blackout periods affecting plan investments.

In early December, it became apparent that Enron would enter bankruptcy. Because the health and pension benefits of workers were at risk, we initiated our rapid response participant assistance program to provide as much help as possible to individual workers.

On December 6 and 7, 2001, the Department, working directly with the Texas Workforce Commission, met on-site in Houston with 1200 laid-off employees from Enron to provide information about unemployment insurance, job placement, retraining and employee benefits issues. PWBA's staff was there to answer questions about health care continuation coverage under COBRA, special enrollment rights under HIPAA, pension plans, how to file claims for benefits, and other questions posed by the employees. We also distributed 4500 booklets to the workers and Enron personnel describing employee benefits rights after job loss, and provided Enron employees with a direct line to our benefit advisors and to nearby One-Stop reemployment centers. These services were made available nationwide to other Enron locations.

PWBA regularly works throughout the country to assist employees facing plant closings, job loss or a reduction in hours, and subsequent loss of employee benefits. Our regional offices make it a top priority to offer timely assistance, education and outreach to dislocated workers.

I am pleased to announce that we have just activated a new Toll Free Participant and Compliance Assistance Number, 1–866–275–7922 for workers and employers to make inquiries regarding their retirement and health plans and benefits. The Toll Free Number is equipped to accommodate English, Spanish, and Mandarin speaking individuals. Callers will be automatically linked to the PWBA Regional Office servicing the geographic area from which they are calling. Benefits Advisors will be available to respond to their questions, assist workers in understanding their rights or obtaining a benefit, and assist employers or plan sponsors in understanding their obligations and obtaining the necessary information to meet their legal responsibilities under the law. Callers may also access our publications hotline through this

number or they may access them on the PWBA website. Some of the publications available are: Pension and Health Care Coverage—Questions & Answers for Dislocated Workers, Protect Your Pension, Health Benefits Under COBRA, and many more. Workers and employers may also submit their questions or requests for assistance electronically to PWBA through our website, www.askpwba.dol.gov.

PWBA Benefits Advisors also provide onsite assistance in conjunction with employers and state agencies to unemployed workers—conducting outreach sessions, distributing publications, and answering specific questions related to employee benefits from workers who are facing job loss. In fiscal year 2001, we participated in onsite outreach sessions for workers affected by 140 plan closings. So far this year, we have participated in 106 rapid response events reaching nearly 40,000 workers.

The Rapid ERISA Action Team (REACT) enforcement program is designed to assist vulnerable workers who are potentially exposed to the greatest risk of loss, such as when their employer has filed for bankruptcy. The new REACT initiative enables PWBA to respond in an expedited manner to protect the rights and benefits of plan participants. Since introduction of the REACT program in 2000, we have initiated over 500 REACT investigations and recovered over $10 million dollars.

Under REACT, PWBA reviews the company's benefit plans, the rules that govern them, and takes immediate action to ascertain whether the plan's assets are accounted for. We also advise all those affected by the bankruptcy filing, and provide rapid assistance in filing proofs of claim to protect the plans, the participants, and the beneficiaries. PWBA investigates the conduct of the responsible fiduciaries and evaluates whether a lawsuit should be filed to recover plan losses and secure benefits.

Our investigation of Enron was begun under REACT. Because I do not want to jeopardize our ongoing Enron investigation, I cannot discuss the details of the case. Without drawing any conclusions about Enron activities, I will attempt to briefly describe what constitutes a fiduciary duty under ERISA, how that duty impacts on investment in employer securities, the duty to disclose, and the ability to impose blackout periods.

Determining whether ERISA has been violated often requires a finding of a breach of fiduciary responsibility. Fiduciaries include the named fiduciary of a plan, as well as those individuals who exercise discretionary authority in the management of employee benefit plans, individuals who give investment advice for compensation, and those who have discretionary responsibility for administration of the pension plan.

ERISA holds fiduciaries to an extremely high standard of care, under which the fiduciary must act in the sole interest of the plan, its participants and beneficiaries, using the care, skill and diligence of an expert—the "prudent expert" rule. The fiduciary also must follow plan documents to the extent consistent with the law. Fiduciaries may be held personally liable for damages and equitable relief, such as disgorgement of profits, for breaching their duties under ERISA.

While a participant or beneficiary can sue on their behalf of the plan, the Secretary of Labor can also sue on behalf of the plan, and pursue civil penalties. We have 683 enforcement and compliance personnel and 65 attorneys who work on ERISA matters. In calendar year 2001, the Department closed approximately 4,800 civil cases and recovered over $662 million. There were also 77 criminal indictments during the year, as well as 42 convictions and 49 guilty pleas.

President Bush's Plan

Less than one month ago, President Bush formed a task force on retirement security and asked me, Treasury Secretary O'Neill and Commerce Secretary Evans to analyze our current pension rules and regulations and make recommendations to ensure that people are not exposed to losing their life savings as a result of a bankruptcy. In his State of the Union speech, the President reiterated his commitment to improving the retirement security of all Americans.

The President's Retirement Security Plan, announced on February 1, would strengthen workers' ability to manage their retirement funds more effectively by giving them freedom to diversify, better information, and access to professional investment advice. It would ensure that senior executives are held to the same restrictions as American workers during temporary blackout periods and that employers assume full fiduciary responsibility during such times.

Under current law, workers can be required to hold company stock in their 401(k) plans for extended periods of time, often until they reach a specified age. Workers lack the certainty of advance notice of blackout periods when they cannot control their accounts, lack access to investment advice and lack useful information on the status of their retirement savings. The President's Retirement Security Plan will provide workers with confidence, choice and control of their retirement future.

The President's plan would increase workers' ability to diversify their retirement savings. The Administration believes employers should continue to have the option to use company stock to make matching contributions, because it is important to encourage employers to make generous contributions to workers' 401(k) plans. However, workers should also have the freedom to choose how they wish to invest their retirement savings. The President's Retirement Security Plan will ensure that workers can sell company stock and diversify into other investment options after they have participated in the 401(k) plan for three years.

The President is also very concerned about blackout periods, and the Retirement Security plan suggests changes to make blackout periods fair, responsible and transparent. Our proposal creates equity between senior executives and rank and file workers, by imposing similar restrictions on senior executives' ability to sell employer stock while workers are unable to make 401(k) investment changes. It is unfair for workers to be denied the ability to sell company stock in their 401(k) accounts during blackout periods while senior executives do not face similar restrictions with regard to the sale of company stock not held in 401(k) accounts. Because the oversight of stock transactions of senior executives may go beyond the jurisdiction of the Department of Labor's regulation of pension plans, I will work with the appropriate agencies to develop equitable reform.

The President's Retirement Security Plan ensures that workers will have ample opportunity to make investment changes before a blackout period is imposed by requiring that they be given notice of the blackout period 30 days before it begins. Although employers regularly give advance notice of pending blackout periods, an explicit notice provision will give workers assurance that they will know when a blackout period is expected.

As my testimony stated, ERISA may limit the liability of employers when workers are given control of their individual account investments. The President's Retirement Security Plan would amend ERISA to ensure that when a blackout period is imposed and participants are not in control of their investments, fiduciaries will be held accountable for treating their workers' assets as carefully as they treat their own. Of course, employees would still have to prove that the employer breached a fiduciary duty in order to seek damages.

The President's plan calls on the Senate to pass H. R. 2269—the Retirement Security Advice Act—which passed the House with an overwhelming bipartisan majority. We believe it is important to promote providing professional advice for workers. The bill would encourage employers to make investment advice available to workers and allow qualified financial advisers to offer advice if they agree to act solely in the interests of the workers they advise. Partnered with the proposed increased ability for workers to diversify out of employer stock, investment advice services will be more critical than ever.

Finally, the Administration recognizes that workers deserve timely information about their 401(k) plan investments. To enable workers to make informed decisions, the President's Retirement Security Plan will require employers to give workers quarterly benefit statements that include information about their individual accounts, including the value of their assets, their rights to diversify, and the importance of maintaining a diversified portfolio. As Secretary of Labor, I would be given authority to tailor this requirement to the needs of small plans. Again, in combination with investment advice and the ability to diversify, quarterly, educational benefit statements will give workers the tools they need to make sound investment decisions.

Conclusion

The private pension system is essential to the security of American workers, retirees and their families. While the current scrutiny is appropriate and welcome, we must strengthen the confidence of the American workforce that their retirement savings are secure. The challenge before us today is to strengthen the system in ways that enhance its ability to deliver the retirement income American workers depend on. We must accomplish this without unnecessarily limiting employers' willingness to establish and maintain plans for their workers or employees' freedom to direct their own savings. The President's Retirement Security Plan strikes just such a balance.

We look forward to working with members of this Committee in continuing this discussion and in developing ways to achieve greater retirement security for all Americans.

The CHAIRMAN. Thank you very much, Madam Secretary, for your statement.

We will follow a 6-minute rule so that all of our members will be able to ask questions.

First of all, Madam Secretary, on another subject but one of great importance to this committee, and that is on the ergonomics rule, we have invited you—we sent you a letter some weeks ago, giving you several days for possible hearing. This is a matter of enormous importance to this committee. You indicated that you were going to have some proposals at the end of last year, and we have not had those. It is a matter of urgency, and I do not know what you will be able to tell us about your availability to the committee so that we can have some discussion about where the administration is on that subject matter.

Secretary CHAO. This is a very important topic. I, as Secretary of Labor, have devoted more time to this subject than any other Secretary of Labor. We had hoped to have an announcement on this issue by the end of the year. Certain events toward the latter part of last year slowed down that timetable.

I am hopeful that we will be able to move quickly on this. As I mentioned, I have spent more time on this issue than any other Secretary, so I hope that we will move quickly on this.

The CHAIRMAN. We had asked for you to appear on the 28th, and there was a conflict, and we suggested February 11, 14, and 26. If, after today—we are glad to see you today, and we want you to come back——

Secretary CHAO. I am always glad to be here. I will take a look at the dates.

The CHAIRMAN [continuing]. But as you have pointed out, it is a matter of enormous importance and consequence, and we want to work with you on that matte, so we hope that you will be able to find some time for us.

I listened carefully to your presentation. You talked about the importance of diversity and diversification as crucial to reducing risk. You talked about the freedom of individuals to be able to make decisions and choices about the resources. We had some excellent testimony earlier today from Senator Corzine and Senator Boxer and Congressman Bentsen, but particularly with regard to Senator Corzine about what happens in the major financial houses and money managers in this country who spend their lives managing resources, managing funds and how they, as prudent money managers, in mutual funds set a limitation of 5 percent; the major companies, Goldman Sachs, Lazzard Freres, and J.P. Morgan all have similar kinds of limitations, when they have absolutely complete, overwhelming information with trained professionals, people who give their lives to money management because they know the importance of diversification in order to protect their investors.

We are now talking about retirement security, which is of very, very special value. In the Corzine proposal, people will obviously have flexibility to be able to invest their resources in the stock of a company, completely freely, without any kind of interference if they want to. But when talking about retirement security, the value of retirement security which is so important to families, the fact that we as a matter of national policy underwrite that, anywhere from $60 to $100 billion a year in terms of taxpayer funds, to encourage retirement security, why doesn't it make sense to

have some kind of limitation and expect that we set the minimum standards as those who are dealing with money management establish basic safety programs in terms of giving the assurance to American workers that their retirement funds are going to be as protected as they can be?

Secretary CHAO. The professional money managers are basically managing other people's money, and we are basically talking about the difference between a defined benefit plan and a 401(k).

The defined benefit plan does not give workers choice or control. The 401(k) plan, which is what we are talking about right now, gives workers choice and control in that it is their money; they make the choice as to how to invest it, and they have control as to what investment they want to go into.

A lot of rich people have access to professional financial advice, and we believe that workers should have that right as well. So we are saying in the President's proposal that workers be given the right to make their own decisions, but they will be empowered to have better information and be supported by professional advisors. But it is their money—the 401(k) plan is different from the defined benefit plan because it is their money.

The CHAIRMAN. Well, Mr. Corzine points out that it is the rich people who are investing in these mutual funds and using the investment houses; it is not the people who are earning the minimum wage. The wealthy people are the ones who use the money managers.

Would you be in favor of raising the 10 percent limitation on the defined benefit program?

Secretary CHAO. I think that is currently in the law, and to open it up at this time probably——

The CHAIRMAN. Why not? Why not change that as well?

Secretary CHAO. Because the 10 percent applies only to the defined benefit plan.

The CHAIRMAN. Why not free that up as well?

Secretary CHAO. Because the defined benefit plan is not controlled——

The CHAIRMAN. But do you want to change that? Why not go for freedom all the way, then?

Secretary CHAO. Because the defined benefit plan does not give workers the control. They cannot make their own decisions.

The CHAIRMAN. But I am asking you should we give them that control, why not give them that control?

Secretary CHAO. Well, the choice is in the 401(k) plan. They are two different programs.

The CHAIRMAN. But why not give them the control in the other as well? Why not eliminate—why not say let us give all workers control and go back to where we were evidently in the Studebaker case, where people lost their retirement.

Secretary CHAO. In a lot of Fortune 500 companies where you have a 401(k), 90 percent of those plans are actually backed up or have the defined benefit plan as well. The defined benefit plan, as I mentioned before, does not allow workers the flexibility to make their own investments. The 401(k) plan does. The 401(k) plan is the workers' money; they have saved it over the years, and they

have a choice as to what investment it goes into. The defined benefit plan does not offer that option.

So when somebody else is managing your money, and you do not have any choice as to what investment that money can go into, whoever is managing it should have some restrictions; they have got to have some restrictions as to what they can do, and part of that is security for the workers.

The CHAIRMAN. This will be my final question. Secretary Chao, outside of the fact of the sale, the lockdowns, and some notification, I do not see how you could give any assurance to any Enron worker, or certainly to anyone from Polaroid in my own State, or from Lucent Technologies, that they would not have lost their retirement as well if they had stayed in those companies.

Secretary CHAO. I do not think Government can guarantee economic success of any kind, and clearly, what we are trying to do here——

The CHAIRMAN. You do not think we have some responsibility to minimize that risk, in any important way?

Secretary CHAO. Of course, we do, and that is what we want to do here. We want to preserve for workers their freedom of choice and also control over their own investment portfolios, and under some of the other plans mentioned, they were never in control of it in the first place; outside people were controlling it, so therefore, these outside people should have some restrictions. But for 401(k)'s, these are totally within the control of an individual worker. That individual worker should retain the right to control his or her own investment decisions. It is their right. They may or may not want to exercise it, but it is their right.

The CHAIRMAN. You are not suggesting that any worker can choose any stock they want in a 401(k), are you, because employers make those decisions, don't they?

Secretary CHAO. No. Most 401(k) plans—you are talking about the employer matching portion. There are two parts to 401(k)'s.

The CHAIRMAN. I understand, I understand.

Secretary CHAO. One part is the employee contribution——

The CHAIRMAN. The matching, yes, I understand that.

Secretary CHAO [continuing]. And that, they can choose whatever they want, depending on what the company offers.

The CHAIRMAN. The company offers it.

Secretary CHAO. Yes.

The CHAIRMAN. So it is not completely open choice.

Secretary CHAO. Most 401(k) plans have a tremendous array of mutual funds and different stocks that employees can go into. I think that what you are saying is the match in company stock.

The CHAIRMAN. Senator Gregg?

Senator GREGG. I do think it is important to clarify this difference between a defined contribution plan and a defined benefit plan, because there is some confusion, and for the layperson to understand it is difficult because it is a complex issue. But when you get right down to it, the bottom line is this—the defined benefit plan guarantees you a return; basically, you are going to get so much in your retirement under a defined benefit plan. Under a defined contribution plan, basically, you are competing in the market-

place, and you may get more, you may get less, depending on how the marketplace does with the assets that you have.

So the logic behind the ERISA rules relative to the defined benefit plan is tied to the fact that it is basically an annuity. You basically have to get a return to the employee when he or she retires of "x" number of dollars, and in order to accomplish that, you have got to make certain investment decisions which are traditional to annuity-type activities. That is why there is a difference here.

Secretary CHAO. May I also add one other thing, Senator? Mobility is very important. Nowadays, workers move around a great deal. So under a defined benefit plan, if they leave early, prior to their retirement, they will not get very much.

Thank you.

Senator GREGG. Defined benefit plans have unfortunately fallen off the favorability charts, which is too bad. We have got to come up with systems to reinvigorate them. But the difference in the investment structure hides the fact that the results are entirely different, and the intent of the results are entirely different.

In my viewpoint, as I said in my opening statement, this issue comes down first to accounting. Obviously, if you do not have accurate accounting, you can be defrauded as an employee, and that is what happened at Enron; people were told their stock was worth $90, and it was probably worth $9, because the accounting firms did not give accurate numbers to the marketplace, and the marketplace did not value the stock accurately.

But the second issue that I think it comes down to is vesting. When does the stock that the company delivers to you as part of your employment—when do you get control over that stock and then have the freedom to make the decision to sell the stock or to hold the stock? That should be your right to make that decision. If you work for Wal-Mart, and Wal-Mart makes up 50 percent of your assets because that is what you wanted, you should be able to do that, but you should have the information to do that, which is the point of the President's plan. But second, the issue of when do you get that right to free up that stock and make a move with it is the issue.

I have been toying with the concept of—there are legitimate reasons why a company and why management and why employees enter an agreement which says you have got to work for 3 years before you get the right to the asset. There are obviously legitimate reasons for keeping people interested in their jobs. So immediate vesting would obviously, in my opinion, fundamentally chill the willingness of corporations to participate by giving you extra assets for working longer for them.

But still, couldn't there be a middle road here—and I would be interested in your thoughts on what the chilling effect of this would be—if you were to say that when a corporation delivers you stock as part of your 401(k), you still have 3 years before you own that asset, but during that 3-year period, you have the right to dispose of that asset. In other words, you can make a choice during those 3 years to sell that stock, the proceeds of which would go into the account, which would continue not to be yours until you had worked for 3 years, but you might change it over to another stock, or you might put it into cash. But you would have the right during

that 3-year period to actually dispose of the corporation's stock, although you would not actually own the asset which you had moved it into until the 3 years was over.

Would that address this issue—it would obviously address the issue of the employee being locked into his stock—but would it have an unusually chilling effect on corporations being willing to participate in this type of structure and being willing to put their stock up?

Secretary CHAO. I have three answers. One, I think there will be a chilling effect, because number one, we want to encourage employers to compensate their employees, and employer stock is an option; so we want to encourage that.

Senator GREGG. This would not limit their ability to do that. They could still put stock in.

Secretary CHAO. Having said that, let me also say that vesting is a schedule that Congress has mandated. Basically, last year, the Congress reduced vesting from 5 years to 3 years, and that is how——

Senator GREGG. This would not change the vesting.

Secretary CHAO. But that is how I think our proposal came up with 3 years. Also, interestingly enough, I believe Senator Boxer and Senator Corzine's bill talks about allowing diversification 90 days after vesting, so that would be within 90 days after, we believe, the 3 years. So I think it is even longer than our proposals. But we want to work with you on this.

Senator GREGG. My point is that if a corporation can still match with their stock, but once that match occurs, the individual has the right to dispose of the stock but they do not own the asset until the 3 years has run, is that going to have a negative impact on corporations using their stock as part of the match?

Maybe it is, maybe it is not, but I see it as a way of resolving this issue of ending up being tied up in a corporation's stock as an employee until you are free as a result of vesting rules.

Secretary CHAO. Well, Senator, let us talk further about that, then.

Senator GREGG. I appreciate your time. Thank you.

The CHAIRMAN. Senator Dodd?

Senator DODD. Thank you, Mr. Chairman.

Welcome, Madam Secretary, to the committee.

Secretary CHAO. Thank you.

Senator DODD. I missed your opening statement, and I sort of wish we could bring Jacob Javits back, having written the ERISA legislation. Senator Kennedy often says that we would like to have him come back because this is a terribly complex area of law, and obviously, there is a great deal of frustration, obviously felt primarily by those who have lost so much in the last number of weeks, and I think frustration as well by people who want to do something about it, and in the desire to do something about it, obviously, when we are dealing in the area of pensions and retirement plans, we need to be careful, and I think that is a worthwhile note.

We have an awful lot of people who have our money well-invested today—$4 trillion invested in private pension systems—46 million Americans are earning pension benefits on the job. So as

we move forward here, I think all of us want to make sure that we are not going to create a bigger problem than the one we are trying to solve.

I am curious about what rights and powers you have today under existing legislation. We are talking about changing some of the laws here. What I want to know is can you do some of these things right now, without having to wait for Congress to act? For instance, on these lockdown periods, I asked Jon Corzine the question—on the notification, I think the President has said 1 month notification prior to a lockdown occurring. Is there anything in the existing law that would prohibit you from making that 6 weeks, or the period of lockdown briefer—parity issues between employers and employees where, really, the sense of fairness is what highly offends people, aside from the period of lockdown. It is the sense of outrage. It is almost like the burning building where the owner got out, and the rest of the doors were locked.

Secretary CHAO. Absolutely.

Senator DODD. So the sense of injustice, of telling people to invest in this particular operation with one hand and on the other, they are selling their own stock back to their own company as fast as they can to cash out—that, as much as anything—obviously, the loss of income is huge—but that sense of unfairness—the portability issues.

I want to know what you can do without necessarily waiting for us. Why don't you address that issue first—what is your flexibility as Secretary of Labor in this area?

Secretary CHAO. We did initially take a look at the possibility of our acting on this administratively, understanding how complex ERISA is. But these are such important issues that we felt it was really important to wipe away any gray areas and to——

Senator DODD. Is there a problem with parity, for instance? Why is there any problem with treating the employer and the employee alike on the issue of lockdown? Here, you had the employer selling, and the employee could not.

Secretary CHAO. We totally disagree with that, and that is why the President——

Senator DODD. Can you take care of that now? Do you have to wait for us?

Secretary CHAO. ERISA does not take care of stock options, for example. The President feels very strongly about this point, that there should be pension parity, and that during lockdown periods, if workers cannot sell——

Senator DODD. That is going to require a change of law to do that.

Secretary CHAO. Yes. But I understand your point, and will go back and take a look to see what we can do administratively. But we have taken a look at that, and we felt that, again, this is such an important issue that we wanted to codify it into law.

Senator DODD. Just briefly, some companies—I talked to a chief executive officer of a major U.S. corporation—I will not mention the name right now because I want to be careful that I do not misquote him in some way—in his company, none of the employees can own any stock in their retirement plans, any stock in the company they

work for. He does not want them to do that because of the potential liability.

How often is that done, and do you think that his decision is a wise one in light of what has happened?

Secretary CHAO. I think his decision is a wise one, and I think most CEOs are probably looking at their own companies to see how they can encourage their employees to increase diversification and decrease ownership of company stock.

Senator DODD. What about independent advisors for retirement plans that are not necessarily paid for by the company, so that the sense of having investment decisions for retirement plans being made independent of the resources of the company itself, so they are free of potential pressures that might occur?

Secretary CHAO. We think that workers and employees should have access to good, reliable financial information so that they can make wise investment decisions. As I mentioned before, lots of rich people have it, so why can't rank-and-file workers have it.

So we want to give workers that right, and we want to make sure that investment advisors, if they have any conflict of interest, State so, and that if any fees are connected with the services that they are offering, they State so as well.

Senator DODD. But you think that just notice is enough—would you prohibit it, so that if there is a conflict, if one is being paid by the company itself to do that——

Secretary CHAO. I think here is a balance as well. The fiduciary responsibilities of ERISA are strong, and we are trying to make them stronger with our current proposal. But the investment advisors are supposed to act solely in the interest of their employees, and we want to again shore that up and protect workers.

Senator DODD. Finally, I know there is an investigation being done by the Department of Labor about what happened here. Do you have any sense that you can share with us now of when we can expect to hear?

Secretary CHAO. I have a great group of professionals, and I am very proud of them. They are doing a great job. I am asking them to conduct this investigation thoroughly, in a responsible fashion, as quickly as possible, without compromising the integrity of the investigation.

Senator DODD. I appreciate that, but do you have any sense of when we are talking about?

Secretary CHAO. I hope soon.

Senator DODD. Would that be June?

Secretary CHAO. I hope not; I hope sooner than that—because again—I have said this on many occasions—I am personally committed to helping these workers at Enron, and we want——

Senator DODD. I do not expect you to put a date on it, but I am just curious—so, sometime late winter, early spring is what you would be looking at?

Secretary CHAO. I am pushing as hard as I can.

Senator DODD. OK. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman. I appreciate your holding his hearing. I am sorry that I had a conflict with the national

prayer breakfast; that always falls on the first Thursday of February every year. So I hope we can keep that on the calendar in the future so we do not run into that conflict.

For the past couple of days on the Banking Committee, on which I also serve, we have been talking about financial literacy and have had some tremendous witnesses who have pointed out some of the things that we can do to make it more possible for every person in America to protect their investments and, more important, for the 46 million Americans who have pensions to protect their pensions.

Congress has worked these issues before, and I have always said that a rule of legislating is that if it is worth reacting to, it is worth overreacting to.

One of the reasons why we have this problem right now is because Congress was afraid that if people owned stock in their own company, and they heard some rumors about their company, which might be just a notification that there is going to be a blackout period, they would anticipate that something terrible was happening and sell off their stock, and a massive selloff of the stock would drive the price of the stock down, at which point the public is buying it up at bargain rates.

We said we do not want that to happen to employees, so let us keep them from being able to sell their stock off unwisely. Sometimes we can create problems that we do not anticipate.

I have been an accountant. I am sorry that they are trying to make that a bad profession at the moment. I am very proud of it, and I think it provides transparency in information for people in America and in fact around the world to be able to make good business decisions. That does not mean there cannot be illegal acts that are done, but there are a lot of good accountants out there who provide for the ERISA required accounting that is done. I used to do that for a firm and have been through the ERISA audit. I have been hearing about how maybe we should force companies to change auditors every couple of years.One of the things that is already provided for in ERISA is a very extensive questioning if you change auditors, because the implication is that if you change auditors, you are doing it because you have found somebody who will do accounting for you that you ought not be doing, so current law under ERISA has a check to make sure that does not happen. Maybe now what we are going to do is institute some questions on the other side of the issue, and that might be a good idea, too, so that we are getting the full story on the audit.

I am concerned a little bit about the small businesses out there, the start-up businesses, which can often become pretty big businesses in a hurry. One of their difficulties is having cash flow, and so to provide for the retirement of their employees, they are providing a stock contribution in their defined contribution plan—almost everybody goes with a defined contribution now, because a defined benefit plan says that you are going to guarantee after retirement a certain amount of retirement, and that is hard to do in this day and age, and also, people have discovered that they can perhaps make more than the defined benefit if they just invest their own contribution. But under the defined contribution plan, some of these small and medium businesses are giving their employees company stock, and most of those people are involved in the start-

up of the company as well, and they feel like they are keeping track of what is happening in that business, and they are very pleased with the growth.

I am wondering what you think the reaction will be now, if we tell them they have a very limited amount of that company stock they can own.

Secretary CHAO. As I said in my testimony, we want to encourage diversification, but it is a right of workers who are in 401(k) plans to be able to make their own investment decisions as to what stock they invest in, and we should be empowering them with good information so that they can make wise decisions.

Your point about small business is a very apt one. It is a concern, and I hope that we will be sensitive to it.

Senator ENZI. I do realize that most of the stock is held by employees of large companies; their sheer size results in them doing that. In fact, I think the average size of one of these plans is about 21,000 participants, so we are not talking small business here, we are talking big business.

Secretary CHAO. Right, I understand.

Senator ENZI. The new law would affect these people who—I think you stated that in the 401(k) plans, just 10 percent of all company stock is held by stand-alone plans?

Secretary CHAO. No. This is in Fortune 500 companies.

Senator ENZI. Yes, in the big companies.

Secretary CHAO. Right.

Senator ENZI. So the rule that we are talking about imposing here, if it applies to big companies, may be a criterion that is already met?

Secretary CHAO. We need to be sensitive to the impact on small companies.

Senator ENZI. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Mikulski?

Senator MIKULSKI. Thank you very much, Mr. Chairman and Secretary Chao.

First of all, Mr. Chairman, thank you very much for holding these hearings, and I ask unanimous consent that my statement go into the record.

I am pleased to be able to say to my colleagues that I am a sponsor of both the Boxer legislation and the Corzine legislation. I think they go a long way in furthering the debate.

Ms. Chao, I want to come to those involved in defined benefits, and I do understand the difference between defined benefit and defined contribution. There is another issue—I am seeing a crisis here in pensions and health care benefits across the board. Let me go to a trend that I am seeing where companies are filing for bankruptcy, and part of the reason why they are filing is to begin the process of abandoning their legacy cost.

Secretary CHAO. Terrible.

Senator MIKULSKI. It is terrible, and I am not saying that it is malevolent.

I want to go to the steel industry—and again, this is not finger-pointing, this is pinpointing. Could you comment—first of all, we know that in the manufacturing sector, which has been the heart and soul of America and which by its very nature has a very clear

defined benefit program, it had the benefit of advocacy of labor unions who worked in the employees' interests, and now, with the excess capacity in the automobile industry, with the crisis facing steel, so many of the steel companies are in bankruptcy, and some are actually going into court under bankruptcy to be relieved of their pensions and their health care responsibilities. Could you tell us what the administration's role is going to be in this? I am not questioning motivation, but the outcome is that we will provide the safety net under the pension guarantee for pensions, but there is no guarantee for health care benefits, and we could end up with 38,000 steel workers without health care, we could end up with them in a fixed pension—usually, they are frozen.

So I just wonder, while we are looking at pension security, what is the administration's involvement in this, and also, are you looking at—again, recognizing that we cannot stop anyone from filing bankruptcy or whatever—what we are going to do about this trend that seems to be cascading through America's private sector.

Secretary CHAO. Let me first say on the steel issue that this administration has done more to highlight the very competitive industries that steel is in and has done more to try to help workers than the previous administration.

This administration starting last year has assembled a Cabinet-level task force which has been in continual discussions with unions and organized labor and with management in this industry to try to find solutions. In fact, this administration petitioned for the first time in well over 9 years before the International Trade Commission on a 201 action, and the ITC has come out with some study, and we are now in the process——

Senator MIKULSKI. Ms. Chao, I want to acknowledge that, and I want to say thank you. The administration has been quite muscular on the issues——

Secretary CHAO. They are continuing to work on this.

Senator MIKULSKI. Right, but let us to go health and pensions. Here, under the react team, the enforcement team that is supposed to act in an expedited manner to protect the rights and benefits, has that been activated for steel——

Secretary CHAO. Yes.

Senator MIKULSKI [continuing]. And where is the administration heading on steel——

Secretary CHAO. We have had national——

Senator MIKULSKI [continuing]. I am sorry. I have 8,000 people who are pretty vulnerable here.

Secretary CHAO. I am concerned about that, too. We have had react teams out. We have had national emergency grants that have been available, obviously. But we want to keep these jobs there. That is the most important thing. We want to have jobs available.

So the administration continues to battle on in terms of fighting for steel rights internationally, trade issues. There is currently trade promotion authority combined with trade adjustment assistance that is going through Congress, which is not yet passed by the Senate——

Senator MIKULSKI. Right, but let us talk about the legacy cost, the legacy cost of health and pensions, because where I see it heading is that we could end up holding the unfunded liability and it

could go to pension guarantee, costing taxpayers buckets of bucks, and at the same time, they will lose their health care benefits, throwing them into the ranks of the uninsured.

Secretary CHAO. I see.

Senator MIKULSKI. I just wonder where we are on that. I want to acknowledge what you have been doing on the jobs issue. It has been outstanding, and I want to say thank you.

Secretary CHAO. I think there—I am sorry.

Senator MIKULSKI. I just want to say that I know what you are doing on the jobs part, and I think it has been outstanding, and I want to say thank you.

Secretary CHAO. I think this is obviously an issue of continuing concern, and I do not think any decision—they are still looking at it. I think everyone is very concerned about this issue. The task force is looking at this and other issues as well.

Senator MIKULSKI. Do you have a direction and a timetable on this?

Secretary CHAO. I am not a main player in that task force, so I do not have a good view, but obviously, it is an urgent issue, it is a priority. We have had several other Cabinet officers who have been involved in this as well since the very beginning.

Senator MIKULSKI. Well, I really just want to reiterate——

Secretary CHAO. I will carry that message back.

Senator MIKULSKI [continuing]. First of all, the job issue, but then, when we look at the pension issue, I am concerned not only about the workers having a pension, but I am worried that the taxpayers are going to have to shoulder the responsibility through pension guarantee and then also, if so many people pre-Medicare come onto the ranks of health care uninsured, the impact on local health delivery as well as on those families will be catastrophic. I mean, we could be heading for a Chernobyl here. We could be heading for a capitalistic version of Chernobyl in which we have the meltdown both in defined benefit and defined contributions of the benefits that people thought they could have not being there. So just know that I really think—Mr. Chairman, how much time do I have left?

The CHAIRMAN. Your time has expired.

Senator MIKULSKI. OK. Thank you.

[The prepared statement of Senator Mikulski follows:]

(The prepared statement of Senator Mikulski was not available at press time, however, documents are maintained by the Committee.)

The CHAIRMAN. Senator Warner?

Senator WARNER. Thank you, Mr. Chairman.

Welcome, Madam Secretary. My office, like I think every office on Capitol Hill, has simply been flooded with telephone calls and correspondence, and I have found the time to take a number of those calls myself and also to read a lot of the mail that is coming in. It is only generated through people's feelings. No one is telling them to write this. They do it spontaneously. And there is one word that comes out in all of this, and that is "disbelief."

I can best characterize it by one wonderful grandmother who got me on the phone and said, Now, listen here, Senator, we start in life with the teaching of our parents. We then go into our edu-

cational institutions from kindergarten through advanced degrees. We are then, most of us, privileged to have our affiliation with churches or synagogues, as the case may be. And then we have to remain accountable to our own families, our spouses and our children. How did these people just sidestep and abandon all of that history of life's teachings, as the allegations—and I repeat as a lawyer—the allegations lay this fact on the basis of greed on a scale unparalleled in the annals of America's proud record of corporate history.

Now, that is just simple understanding. Folks out there understand that. How did they suddenly turn their backs, so many of them—if it had been one or two, but the allegations indicate it was widespread.

We have got to get down into the details, the Congress working with the administration, and provide our constituents with those answers.

I also came up through the banking and corporate world to public life many years ago, and I was a prosecutor of white collar crime as a young lawyer. I think we have to very carefully here in the Congress go through an enormous fact-finding procedure and not be rushed, and then provide remedies and also oversee the responsibilities of the executive branch to hold these individuals accountable, to be in accordance with civil law and regulation or criminal law and regulation.

Furthermore, as we look at the legislation that Congress will be considering, we have got to strike a balance between how much we try to write into the new laws and regulations with regard to our various investment plans and stockholders and companies and strike a balance. We do not want to take away an individual's initiative to save. We do not want to say to that individual, "You do not have the sense to make your own decisions with regard to your portfolio," nor do we want to deprive that individual from seeking such advice as he or she may desire from other experts.

So we have got to hit a balance as we go along and do it very carefully, because this situation in the eyes of my constituents has shaken the foundations of our great capitalistic system which enables so many to start small businesses to fulfill their dreams to have large businesses or be a part of the mainstream of corporate America.

Just look at the number of individuals today who are stockholders compared to a decade ago, two decades, or three or four decades ago, when it was virtually a rarity amongst our society.

So I would just make those several observations. I wish you well. This committee has strong leadership, and we will do our very best to help you.

Secretary CHAO. Thank you.

Senator WARNER. I welcome any thoughts you might have on this Senator's observations, which basically reflect the views of these wonderful calls and letters that I am receiving, which are expressions from the heart—yes, anger, but that one word, "disbelief," as to how it could happen in America.

Secretary CHAO. Well, as you mentioned, there are a number of investigations going on, criminal investigations and civil investigations. We have an investigation at the Department of Labor which

we initiated before the company went bankrupt. And you have my personal commitment—I will take this investigation wherever it goes, to whomever it takes. I am very concerned about helping these workers and trying to recoup as much as I can on their behalf, and the President is very concerned, which is why in his proposal, he does talk about pension parity——

Senator WARNER. I think that is essential.

Secretary CHAO [continuing]. That during the blackout period, if the workers are prohibited from selling, then so are the CEOs and top executives.

Senator WARNER. I thank you.

Secretary CHAO. Thank you.

Senator WARNER. Thank you, Mr. Chairman.

[The prepared statement of Senator Warner follows:]

PREPARED STATEMENT OF SENATOR WARNER

Mr. Chairman: The mail and telephone calls from concerned, conscientious constituents are just overwhelming. I listen to and read their comments in addition to the daily media reports; with my constituents, I share the utter disbelief at the growing list of allegations of wrongdoing.

I began my professional life in the U.S. Attorney's office prosecuting white collar crimes. That was followed by years of representing banks and investment companies, so I have some basis of understanding of corporate America.

Constituents from every state look at this situation and legitimately ask how this could have happened. Now it is the responsibility of Congress to provide not only answers, but remedies.

Several constituents have asked me how people who have reached the top levels of corporate America so readily abandoned every basic principle of fairness and honesty that began with the care and love of their parents, teachings they received from first grade through their graduate degrees, the support of their churches and synagogues, and the support of their families. How could they have abandoned all their cherished American traditions and succumb to greed unparalleled in the history of corporate America?

The United States free enterprise system is the envy of the world. The opportunity in America to create small business that can grow into big business is the very foundation of our capitalistic system. In the minds of many, the Enron case shakes the very foundation of our system.

Consequently, Congress has the solemn duty to work with the Administration to determine the factors which led to the collapse of Enron and resulted in the largest bankruptcy in U.S. history.

All resources of the Executive, Legislative and Judicial branches of the federal government should see that these allegations are fully and fairly reviewed. Where it is found that there has been a violation of federal law, then there must be full accountability, be it under criminal or civil due process.

After the facts have been established, the Administration should come forward with their legislative recommendation for consideration along with the legislative proposals in Congress. That legislation must first deter any repeat of the situation we are now examining in the Enron case. Secondly, it must provide a balanced, I re-

peat balanced, measure of protection to stock holders, lending institutions and others who support our free enterprise system through the corporate structure.

I say balanced because, to the extent we legislate protection, Congress must be cautious not to unduly curtail the ability of companies to offer such investment and retirement planning incentives to their employees. Nor must we take action that would discourage savings or unduly limit the judgement of individual employee stock holders in making their own informed decisions.

Congress will have to enact laws as it deems appropriate to ensure that this does not happen ever again. It is in this Committee's purview to determine what revisions are necessary in current pension laws to restore the confidence of the American worker and investor.

An essential principle must be that of "pension parity" between a company's management as well as down to the newest employee stockholder. The company's CEO, as all top management, must adhere to the same restrictions during a lockdown or blackout period when stock transactions are prohibited as the employee stock holders.

To the fullest extent possible, disclosure of company financial status and other data relevant to making an informed investment decision is essential for individuals to have the freedom and ability to make sound investment choices, and to seek the advice they desire.

Congress must act timely, but must not rush. For the present, we should fairly and fully proceed with our fact finding mission. I am committed to working with my colleagues to make the appropriate revisions to our laws and preclude this from ever happening again.

I welcome the witnesses.

The CHAIRMAN. Senator Bingaman?

Senator BINGAMAN. Thank you very much.

Madam Secretary, thank you for being here. Let me start by saying that I think there are some very useful and constructive proposals and provisions in what you, the administration and the President, have come up with.

There is one area that I have concerns about, and that is on this issue of investment advice. Currently, there are various prohibitions against any investment advice being provided where there might be a conflict of interest. I have introduced a bill with Senator Collins and Senator Mikulski that also ensures that any investment advice that is given to employees is qualified and is independent, and that there not be a conflict of interest involved with the person or the company that is providing that advice.

As I understand your legislation, you say that conflicts can exist, but they must be disclosed; investment advisors can have a conflict, they just have to disclose it to the employee. And I am concerned that that is not enough. I can remember when I started practicing law, the senior member in the law firm, for whom I had great respect, called me into his office and said, "We have one rule in this firm, and that is if we identify a conflict of interest, we get out. We do not satisfy our ethical needs by disclosing the conflict—we get out."

I thought that was a pretty good rule, and I think it is a good rule for us to try. If we are going to legislate in this area, if we are going to provide a safe harbor which encourages employers to assist their employees in getting investment advice, why don't we ensure that that investment advice be independent and not coming from someone who has a product to sell, who has some ax to grind, who has some conflict of interest.

Secretary CHAO. We want workers to get the best advice possible. I think we agree on that. The issue is how to do that. We are also trying to balance between smaller companies who may not be able to hire two different people, one to be the advisor, one to let us say offer a portfolio of mutual funds or whatever. So we thought that we could accomplish this balance by giving workers the knowledge that if there indeed is any conflict of interest—and that need not always be the case—but that if there were, they should know about it, and the disclosure would help them; and if there are any fees involved with a particular instrument, a mutual fund or whatever, a particular stock, that the worker would be notified of that as well.

But it is a balancing act, so let us work together, and I want to work with you on that.

Senator BINGAMAN. So your position is that the requirement that we have in our legislation, which I believe is 1677, the requirement that the investment advice be independent and that there not be some conflict—you think that that is not necessary?

Secretary CHAO. No, because these fiduciaries are supposed to be acting solely in the interest of the employees, and they are supposed to——

Senator BINGAMAN. But we have a lot of examples of fiduciaries who were supposed to be acting in the interest of employees in recent circumstances, and they did not do it.

Secretary CHAO. Yes, there are bad actors, and we obviously need to prosecute them firmly and aggressively. The issue is how do we provide that advice. There would probably be some disincentive for employers from offering that, or they cannot offer as good advice as they could.

Senator BINGAMAN. I think the problem is that you can not be a bad actor and still believe that the investment product that your company happens to sell is the best investment product that an employee could possibly buy. So you are not violating some responsibility; you are giving the best advice you can, but the truth is your advice is colored by the fact that you have a conflict of interest, that you get paid on the basis of how many of these employees you persuade to invest in your company's mutual funds.

Secretary CHAO. These fiduciaries are personally liable for any failures in their pension plans. If you are a fiduciary under ERISA, you are personally liable. We want people to offer good advice. They are supposed to act solely—not even in the best interest, but solely in the interest of the employees, and we feel that if we let people know that they have some outside interest, if we let them know how much these funds cost and other relevant information, they will make good decisions.

Senator BINGAMAN. Well, I think we have a difference of opinion here. I do not think that——

Secretary CHAO. Let us work together on it.

Senator BINGAMAN [continuing]. I do not think that disclosing the conflict is adequate. I had a good friend who used to say, "What I am about to tell you is a secret, so if you repeat to anybody, be sure and tell them it is a secret." That disclosure was not adequate for that circumstance. So I do not think that disclosing a conflict of interest is going to be adequate. I think we should maintain the current prohibition that exists in ERISA against conflict of interest in providing this advice. At the same time, I encourage employers—I think we have come up with a way in the legislation that we have introduced to accomplish more investment advice to employees, which I think is a very good thing.

Secretary CHAO. And again, I will just quickly summarize. I think the issue is that we are trying to make the balance, and if some of the smaller employers had to go out and hire a number of financial advisors, it would be more costly, and basically, workers are going to have to assume that cost.

Senator BINGAMAN. Well, it might turn out to be a very small cost compared to what they wind up losing in their retirement accounts.

Secretary CHAO. Well, let us talk further about that.

Senator BINGAMAN. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bond?

Senator BOND. Thank you very much, Mr. Chairman.

Madam Secretary, I want to congratulate you and thank you for the preparation and the work that you did during this year to be up to speed on this very important area of protecting pensions, because obviously, while no one could have foreseen the huge collapse and the tragedy of Enron, your attention to the concerns and the questions in this area have obviously put you in a position to be able to respond.

From my standpoint on the Small Business Committee, I would say that 401(k) plans have given small businesses a tremendous opportunity to provide their employees with a form of retirement investment in a much more inexpensive manner than the traditional defined benefit plans. And I think that is a huge factor in the growth in popularity of 401(k) programs over recent years. I personally believe that defined benefit plans are better for the employee and the economy as a whole. We have the Pension Benefit Guaranty Corporation to back up defaulting defined contribution plans. We have huge problems in that area with defined benefit plans. And we have Social Security, which is a defined benefit plan, which has to be fixed. And we know that the problems with fixing them are very difficult, so the fact that we have a defined contribution plan in the 401(k) with some problems I do not think in any way suggests that we ought to move back solely to the defined benefit plan.

Although the tragic impact of Enron's collapse has dominated the news, I think we need to remember that there are many outstanding success stories of employees who, with disciplined savings and sound investing, have accumulated significant assets for their retirement. These successes would not have been possible under traditional defined benefit plans.

But here, we have a huge problem of apparent wide-ranging malfeasance, misfeasance, nonfeasance—all the bad kinds of feasance you can have—and this committee ought to look at it, and we ought to decide whether the laws are adequate in terms of protecting pensions. I believe our colleagues on the Banking Committee must look at the accounting and disclosure, the accounting practices aspects, the corporate responsibility assets. We ought to look there, but I think the first effort is going to go on to the Department of Justice to determine whether in fact there was criminal malfeasance, because you can pass all the laws in the world, but you need to enforce those laws, and if that brings criminal penalties with it, then that in itself should deter problems in the future.

So obviously, it is not just this committee, but we need to look in this committee at how we can structure pensions best. But I would ask you first what is your feeling on the desirability of having pensions in defined contribution plans as opposed to defined benefit plans?

Secretary CHAO. We support defined benefit plans, and we support defined contribution plans. They have served different purposes. They are carried by different workers of different ages. Our primary concern is that we are for the workers; we want to protect their long-term retirement security.

Senator BOND. Whether it is defined contribution or defined benefit?

Secretary CHAO. My concern is with the workers. I want to protect their long-term security.

Senator BOND. As long as they are protected.

Secretary CHAO. Right.

Senator BOND. I think that as we look at the pension reforms, we need to give the workers the flexibility and control over their investment options which will enhance their ability to get advice and reliable investment information and make their own determinations. I think that the administration proposal to allow workers after 3 years—is it 3 years that they would be able to divest employer stock——

Secretary CHAO. Congress made that the vesting period last year.

Senator BOND [continuing]. All right. But do you think that is soon enough to allow them—as soon as it vests, should they be able to sell off some of that if they have too much of their stock in the company?

Secretary CHAO. The President's plan supports diversification. We think that is a wise move; we just do not think that that right to make your own decision should be taken away from workers. We want to encourage diversification.

Senator BOND. I would agree with you that a worker may choose to keep his or her money in the stock. He or she may have other investments that balance it out, but they should be fully informed. But if they want to get out, you are saying it is up to them.

Secretary CHAO. It would be after vesting, and that is in the Boxer and Corzine bill as well. I believe theirs says 90 days after vesting; ours says 3 years, which is about the same time.

Senator BOND. Ninety days?

Secretary CHAO. Ninety days after vesting. Their proposals says 90 days after vesting.

Senator BOND. And yours says——

Secretary CHAO. Three years.

Senator BOND. After the plan begins, or is that—is that 3 years after vesting or——

Secretary CHAO. No. It is not rolling; it is 3 years from the time that an employee receives the stock—or, that they become eligible to receive the stock. So it is actually not very much difference.

Senator BOND. Because the vesting period is——

Secretary CHAO. Employees will throughout their career with a company receive stock all the time. So we are not saying that each tranche of stock received at a particular time has to wait 3 years. We are just saying 3 years from the——

Senator BOND. After they begin putting stock into the employee's retirement.

Secretary CHAO. Exactly.

Senator BOND. They could divest the whole thing.

Secretary CHAO. Right. That is for simplification purposes.

Senator BOND. And Senator Boxer and Senator Corzine say any time—okay. Thank you. So 90 days after vesting.

Secretary CHAO. After vesting.

Senator BOND. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Wellstone?

Senator WELLSTONE. Thank you, Mr. Chairman.

I will move right along, because I know we have other witnesses to hear from as well.

First of all, Secretary Chao, I want to welcome you, but I do also want to repeat what Senator Kennedy said at the beginning, and you know where I am heading. It was really a year ago that you said that you were going to have a plan as to what we can do about repetitive stress injury, and I would encourage you to move forward with that. We really want to work with you, and I would just tell you that we have been asking for a staff briefing—as you know, I chair the subcommittee with jurisdiction over this——

Secretary CHAO. Yes, of course.

Senator WELLSTONE [continuing]. And we have not even gotten a staff briefing from the people at the Department of Labor. We need to get that briefing, and I want to be as gentle but as emphatic about that as possible.

Secretary CHAO. I understand, I understand.

Senator WELLSTONE. Second, there was a piece in The Wall Street Journal today, and the opening paragraph reads: "Enron Corporation's bankruptcy may have wiped out most of the retirement savings of most of its workers, but one thing it did not take away were the pensions of its most senior executives. Financial filings disclose that former Enron chairman Kenneth Lay for one used a private partnership to protect millions of dollars' worth of executive pension benefits."

Now, we are talking about pension parity. It does not sound like there is any pension parity going on here. Should we do something about that so that this cannot happen again?

Secretary CHAO. That is certainly within the purview of Congress. ERISA basically just takes care of the fiduciaries and the trusteeships.

Senator WELLSTONE. And would it be your recommendation that we take some action to make sure this kind of thing does not happen again?

Secretary CHAO. I think that is a little above my pay grade.

Senator WELLSTONE. I do not think it is above your pay grade. [Laughter.]

Secretary CHAO. I am concerned about the workers and ERISA and how we can ensure long-term retirement security.

Senator WELLSTONE. I understand. With a twinkle in my eye, I would just say that this does not do a lot for the morale of workers.

Secretary CHAO. And that is why the President's plan says that there has to be pension parity.

Senator WELLSTONE. OK. The third thing I want to do is get your reaction—people are talking about some legislation, and I have introduced a bill called The Retirement Security Pension Act. I just want to run over a couple of things and get your reaction.

At one point, you were saying that employees should have a choice, and I agree, but Enron did not say a word to its employees about diversification, and there were all sorts of pressures to in fact invest in the company, and it did not seem like much of a choice—this is their 401(k) plan, Enron's description of it, and you just do not find anything in here about the importance of diversification or about the jeopardy that you might be in.

So I want to first of all put in a strong word for full and accurate disclosure. And then, the second thing that I want to mention is that I think on the whole question of diversification, there is something that I want to mention here, because I think this was something that Senator Gregg was talking about as well.

In our legislation, we have a mechanism to set limits, but we take into account all of the retirement vehicles available to employees so that, for example, the 20 percent—so you would include both the defined benefit and the defined contribution plans, in which case, it is a little different, and it gives people more flexibility, and frankly, I think it also gives an incentive to employers as well as to employees. So we have the 20 percent threshold, but what we want to take into account are all of the retirement vehicles that are available, which I think makes it less stringent and gives it a little bit more flexibility.

Now, on the whole question of diversification and account access, on the lockdown protections, no longer than 10 days and 30 days advance notice of any lockdown. Senator Gregg was talking about this. You talk about employee freedom of choice. It seems to me that employees ought to be able to move out of company stock to other investments after 1 year. I do not know why we have to wait for 3 years. It seems to me that apart from vesting, if we really want to talk about employees having choice, 1 year makes much more sense, which is in fact what we talk about.

Then, finally, Mr. Chairman—and I want to get your reaction to this as well, Madam Secretary—on the whole question of accountability, I think we need to have tougher remedies. I am talking about civil remedies. I think people ought to be able to take the companies, and for that matter, others that have been parties to this kind of fraud or whatever you want to call it, and be made whole again in court. I think some of the actions that we have

taken in the Congress in the last few years have made that less possible. I think that that is a good disincentive for companies to do this again to their employees. I think you have to have whistleblower protections. And frankly, on these different committees, I think employees ought to be sitting there and ought to be part of the decisionmaking, and they ought to therefore have more access to information and say over what is going on.

I wanted to get your overall reaction to some of the directions in which we go in our legislation.

Secretary CHAO. Senator, first of all, I want to emphasize that I want to work with this committee.

Senator WELLSTONE. I am sorry?

Secretary CHAO. First of all, I want to emphasize that I want to work with this committee.

Senator WELLSTONE. I appreciate that.

Secretary CHAO. This is a matter of great importance to me personally and also to the President. We want to move this issue along and help workers.

Let me just make a couple of comments. You have given me a great deal of thought, and we will certainly take your comments and study them. Let me just make a couple of comments first.

First of all, on the 20 percent in terms of the overall portfolio, while that is better, that is still, we believe, taking away the right of workers to decide what they want to do.

Senator WELLSTONE. And again, I would say what Senator Corzine said—this is on the plans that the Federal Government is providing support to. Employees have freedom of choice.

Secretary CHAO. Right—because we are talking about 401(k)'s, and 401(k)'s are again self-directed. So these workers have that right.

Second, your concern about diversification, we share as well. So part of what the President's proposal would entail is to provide in-depth quarterly statement. An in-depth quarterly statement will be very explicit with visible notification about the need to diversify. And hopefully by that time, we will have some kind of access to professional advisors as well.

The 10-day lockdown—we have a 30-day advance notice of the blackout period that is coming, but we do not have a specific period in mind. But we have something that we believe is even better that is going to motivate companies, because we are taking away their safe harbor provisions. There is something called 404(c) in ERISA which basically says that because 401(k)'s are self-directed, workers bear the responsibility. But in a lockdown period, they lose that autonomy, and the employer therefore has to bear the liability. So we codify this, and we ask for clarification in ERISA. So we are saying that if you are going to have a lockdown period, you are liable for what happens in that pension fund on behalf of your employees. We believe that that is going to be a powerful incentive for employers to make their lockdown periods as short as possible.

Under vesting for 1 year, under a 401(k), an employee can take their employee portion out at any time, whenever they leave. As I mentioned, in terms of the employer matching stock, Congress says 3 years; that is kind of how we came up with 3 years.

Senator WELLSTONE. I am out of time, so I thank you.

Secretary CHAO. Thank you, and let us talk further.

Senator WELLSTONE. Thank you. I appreciate it.

The CHAIRMAN. Senator Reed?

Senator REED. Thank you, Mr. Chairman.

Thank you, Madam Secretary. Section 404(a) of ERISA provides for an exemption for diversification for companies that match their employee contributions with company stock or company real estate. Would you be in favor of repealing that exemption?

Secretary CHAO. No, no, because currently, ERISA puts a cap on defined benefit plans, because defined benefit plans are not controlled by the workers. A 401(k) is a self-directed investment vehicle for the workers, so they have the choice of the control of their own funds. So we would not—they are two different——

Senator REED. Well, as I understand the law—and I must admit I am not an expert in this and would not claim to be—but as I understand it, if the company chose not to offer their own stock or real estate, they would have the requirement to diversify the offerings in their portfolio and much more of a requirement. And it just seems to me that this is one of these loopholes——

Secretary CHAO. I will take a look at it. OK. I will take a look at that.

Senator REED [continuing]. And you can see where there is a huge incentive for companies to match stock, to use their company stock to fund an employee retirement plan; it is virtually zero cost to them.

Secretary CHAO. Right.

Senator REED. Again, what we are trying to do—and the thrust of many of your comments is that there are some bad actors here, and I believe there are—but there is also just the incentive of doing something as cheaply as you can, and that is something that we control by appropriate regulatory and legislative measures that we have to think about.

I would encourage you to look at that issue in terms of diversification. I know that the trustees have a fiduciary obligation, but I think at the core of many of your comments today, Madam Secretary, is that you are assuming that the average worker in a company has the same level of information that the administrators or trustees of a plan do. I do not think that that is the case in reality. It might be a nice thought.

Secretary CHAO. I do not make that assumption at all.

Senator REED. Well, you keep saying we do not want to take away the worker's choice——

Secretary CHAO. And the President's proposal would have professional advisors made available to these workers. That is part of the President's proposal.

Senator REED. And could you elaborate on that, Madam Secretary?

Secretary CHAO. Sure. Basically, we believe that workers are in an environment where they have a lot of choices to make, so in this environment where they have 401(k)'s or what are called defined contribution plans, we want to equip workers with better information. So our proposal, the President's proposal, would require professional advisors to be employed by the employer for the benefit

of the employee and who will act solely in the interest of the employees.

Senator REED. That sounds an awful lot like the proverbial trustee of a plan.

Secretary CHAO. Not really, because the underlying instrument is different. The trustee of let us say a defined benefit plan——

Senator REED. We are talking about the 401(k), defined contribution plan of Enron.

Secretary CHAO. Right, yes. So we are talking about for the 401(k)'s, the trustees have their own responsibilities; they are involved in administering the plan. The investment advisor is different. The investment advisor would be like an employee's personal investment advisor. I mean, rich people have their advisors——

Senator REED. I know.

Secretary CHAO [continuing]. So we want to make sure that employees——

Senator REED. And I would point out that many of those advisors were advising people to buy Enron stock for a very long time, even as it fell.

Secretary CHAO. Well, you know——

Senator REED. But there is a second question——

Secretary CHAO [continuing]. But the basic issue remains that rich people have access to financial expertise, and I think workers should have that access as well. So that is what we are tying to do.

Senator REED. Would this be a mandatory requirement of the company, or would this be a voluntary, permissive encouragement?

Secretary CHAO. We would require that.

Senator REED. So it would be mandatory.

Secretary CHAO. This is, for example, the Retirement Security Advice Act that just passed the House.

Senator REED. And the company would hire the advisor?

Secretary CHAO. Yes.

Senator REED. Why couldn't the worker choose the advisor, since it is all about worker choice?

Secretary CHAO. I think that conceptually, that sounds wonderful; I think that logistically and realistically, that would be a nightmare to handle.

Senator REED. Given the track record, for example, of Enron of hiring people to run pension plans, to give them advice and to do other things, are you confident that they would have picked someone who would have zealously guarded the rights of workers?

Secretary CHAO. Well, if they are not, they are going to go to jail. And if we find that some company folks are doing that, they are going to go to jail.

Senator REED. Madam Secretary, I think we should be thinking not about putting people in jail but about creating a system in which there are not incentives to do stupid or venal things.

Secretary CHAO. I agree. I totally agree.

Senator REED. And frankly, when we unravel this very sordid and, for workers, tragic series of events, we will find some criminality, I suspect, but we will find a lot more venality, we will find

a lot more rules that did not control behaviors. One is the example of diversification.

Another point I would raise is with respect to the lockdown. Your comments to Senator Wellstone I thought were very encouraging, that you would place liability on the company if they went into a lockdown period for as long as it is locked down. What would that liability constitute? Could you explain that now—liable for what?

Secretary CHAO. All fiduciaries of ERISA plans are personally liable, and they would be subject to civil and criminal investigations and penalties.

Senator REED. Well, they are subject right now to those penalties. What difference would this new liability have during a lockdown period? What are the liable for—the loss of profits of the workers individually?

Secretary CHAO. Yes. They would have to make the workers whole.

Senator REED. So the three or four plan administrators would have to make all the workers of Enron—if this were in effect when this terrible thing happened, it would have to make whole all of the——

Secretary CHAO. It depends on—there are people who are fiduciaries who are stated fiduciaries, and there are some who, by their very actions, will be considered fiduciaries.

Senator REED. I understand that. But your point is that some people if they go into a lockdown period will be personally liable for all the loss in the stock value per se just because the stock fell?

Secretary CHAO. They can be, yes. Right now, the employer is not held liable during the lockdown period. We want to make it very clear that they are liable.

Senator REED. But I am still confused, and I do not mean to go back and forth—they would be liable for any lost value of the stock during a lockdown period?

Secretary CHAO. They have the obligation to make the worker whole.

Senator REED. And it would be per se liability—it would not be any type of bad action or negligence or stupidity—it would be per se liable?

Secretary CHAO. Currently, employers are not responsible for the results of investment decisions if they broach their fiduciary liability. So we want to——

Senator REED. But only during the lockdown period.

Secretary CHAO [continuing]. No. We want to make them liable, but it is a fiduciary responsibility. We want to make that very clear.

Senator REED. Thank you, Madam Secretary.

Again, we have all kinds of behavioral theories about what happened, but it strikes me that this is a case of a company that was desperately trying to keep itself afloat and that their goal was not, I think—in fact, I do not think they cared about their workers—they just wanted to see if they could stabilize the stock a bit. And using a lockdown period to me in that sense should be wrong. I think a lockdown is just to administratively change people; they were trying to do something else. Are you going to look into that?

Senator MIKULSKI [presiding]. The Senator's time has expired.

Senator REED. I thank you.

Secretary CHAO. We have an investigation going on that lockdown, and obviously, during the investigation, I cannot say very much, but as I have said to this committee, you have my commitment that we will take this investigation wherever it goes.

Senator REED. Thank you, Madam Secretary. I appreciate that. Thank you.

Senator MIKULSKI. Senator Edwards?

Senator EDWARDS. Thank you, Madam Chairman.

Good morning, Madam Secretary.

Secretary CHAO. Good morning.

Senator EDWARDS. I think one of the reasons why the American people have responded so strongly with respect to what has happened with Enron is that they have seen this story before—people at the top, powerful, well-financed, politically well-connected, have taken advantage of regular working people who were working inside Enron. I think they are also worried about it happening to them and their families and their children.

Can you tell us what you have done to determine whether there are other Enrons out there waiting to happen?

Secretary CHAO. I think it is very hard to predict the future viability of an organization, and I think it is very dangerous to predict, because obviously, that will move markets as well.

I would say that we have an investigation ongoing with Enron. I started that investigation before the company went bankrupt. When the company went bankrupt, we sent our employees down to the company, and we have given information about career options, health care options, what rights they have in a bankruptcy, to help them work through this period. So I am very concerned about these workers. I will do everything I can to help them, and also——

Senator EDWARDS. And I appreciate your concern——

Secretary CHAO [continuing]. And also, the President's plan obviously is looking at ensuring the overall long-term retirement security of all workers, and that includes the unions and corporations, businesses and unions.

Senator EDWARDS. But people around the country who are working and have been working for years, some of them for decades, at companies are not interested in what we are doing here in Washington, DC.

Secretary CHAO. I totally agree.

Senator EDWARDS. They are worried about their own families' and their own families' pension funds. And what I am asking you is, as we sit here today, the law and regulations that applied to Enron are still the law of the land, are they not?

Secretary CHAO. That is why we are asking for action.

Senator EDWARDS. But that is the case. The law that applied to Enron—all the laws and regulations that applied to Enron—are still the laws that apply to companies all over this company, which is why——

Secretary CHAO. The President's proposal would change that, and that is what we are asking for action on.

Senator EDWARDS [continuing]. Yes, ma'am, I understand that. But there are millions of Americans working as you and I sit here and talk about the President's proposal who have the same law ap-

plied to their companies that already existed when the Enron scandal occurred. I am asking you if you have done anything to try to determine whether there are other companies around the country that may be engaging in the same kind of conduct that Enron has engaged in, because——

Secretary CHAO. First of all, I do not think——

Senator EDWARDS [continuing]. Excuse me, if I may finish——

Secretary CHAO. Yes, please.

Senator EDWARDS [continuing]. Because if we have in fact, as we do, millions of people out there working all over the country subject to the same kind of horrible behavior that was engaged in at Enron, the same laws that existed before still apply to them, obviously, people are concerned. I am not asking you about a process question. I am not asking you about proposals and legislation and all the things that are being done by Congress and the President. I am asking you about folks who are out there right now, working, worried that what happened to the people at Enron is going to happen to them—today, tomorrow, next week—before any change is made in the law.

Have we done anything—have you done anything—to try to provide protection to those people by determining whether there are other companies that are engaged in the same activities?

Secretary CHAO. I think, sir, you are an attorney yourself, so I think we need to have the facts. And I do not know what happened at Enron, and I do not think anyone else does at this point. There are criminal investigations going on. There are civil investigations going on. We do not know what ultimately contributed to the demise of that company, and I do not think I can go into any other company and say that you are doing what Enron is doing—I mean, how would I know that?

Senator EDWARDS. Yes, ma'am, but the President has made proposals, so that obviously, you and the President believe that you know enough about what happened to know that the law needs to be changed, and action needs to be taken. My question——

Secretary CHAO. I do not think that is true. I do not think that is true.

Senator EDWARDS. You do not think that is true?

Secretary CHAO. No, I do not. There are investigations ongoing. The results of these investigations are not yet known.

Senator EDWARDS. OK. Then, how is the President making proposals if he does not know the law needs to be changed?

Secretary CHAO. Because I think, based on the preliminary information that all of us have received on what we have seen happen with this company, there are some lessons that we can draw, and the President's plan is to ensure the long-term retirement security of all workers, number one by preserving their right to make their own investment decisions; two, to empower them by giving them the information and professional advice they need to make wise investment decisions; and three, control so that they have parity, so that if some executive is going to sell their stock, workers should be allowed to as well, and if workers cannot, then executives cannot either.

Senator EDWARDS. And is there anything that I can tell people who work in my State, North Carolina, who ask me today, or to-

morrow, or next week, before Congress acts, before the President's proposal is acted upon, anything that is being done to protect them from the possibility that what happened at Enron could in fact happen to them as we speak?

Secretary CHAO. Well, if employees, workers, have any suspicion that their company is engaging in unlawful practices concerning their pensions, I want them to call us. I want them to call the Department of Labor—and I have a toll-free number that I want them to call, because this is a very serious matter. If any employee feels that his or her company is engaging, again, in any untoward, unwise, illegal activity, they need to alert our offices, and we will investigate. The number is 1-866-ASK-PWBA—and I will get on top of it.

Senator EDWARDS. Thank you, Madam Secretary.

Secretary CHAO. Thank you.

Senator EDWARDS. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Just finally, Madam Secretary, on the aspect of the President's proposal that you commented on today about the independence of these financial officers, we have just seen the example of Andersen doing the accounting and also consulting. And now, Andersen Company has indicated that they have now as a matter of policy given that up because of what they think is the real danger of conflict of interest and the appearance of conflict of interest. Are you still satisfied in regard to the kind of money managers who will be giving advice under the President's program, who are going to benefit in varying degrees, depending upon which stocks are selected by the workers themselves, that this does not present a conflict for those individuals who are pushing the investment on these workers?

Secretary CHAO. The conflict of interest that you speak about with Andersen, for example, and the whole issue of accountability is one that needs to be taken a look at. The President has appointed a second task force which is headed by the Treasury Secretary, and it also comprises the chairman of the SEC, the chairman of the CFTC, and the chairman of the Federal Reserve Board, and they should be coming out soon, I hope, with their recommendations on that.

The CHAIRMAN. Well, that is good, but Arthur Leavitt had this nailed 2 years ago.

Secretary CHAO. The blue ribbon committee, yes.

The CHAIRMAN. He had that, and he tried to get it, and it was resisted; it was resisted by Congress and by the companies themselves. But they saw this as a real danger, and I am just wondering why we are not seeing a similar kind of danger of conflict for these money managers who are going to be paid on the basis of what they are able to convince the workers to accept—and as you point out, the workers who are working 40 hours a week, 52 weeks of the year, and are not experts in terms of the managing of these funds, are depending on the information they receive, and then these money managers are receiving their income based upon how much they are able to sell to these workers, and obviously, there will be differentials in terms of the types of stock they will be able to push.

I do not know why this is not on its face going to pose the kind of conflict of interest that will be detrimental to the workers.

Secretary CHAO. I think we are trying to provide a balance. Again, there are some small companies that will not be able to hire two different investment advisors, and ultimately, the cost is going to fall on the workers.

The CHAIRMAN. I want to thank you very, very much. You have been very helpful to us, and we will be looking forward to working with you.

Secretary CHAO. Thank you.

The CHAIRMAN. Thank you very much.

Our final panel today includes Steven Lacey, who is an emergency repair dispatcher for Portland General Electric Salem Division in Oregon. Mr. Lacey joined the company in 1981, and in 1987, Enron bought PGE, and he and his coworkers at PGE have lost virtually all of their 401(k) savings.

Jan Fleetham is a retiree from Northern Natural Gas, an Enron subsidiary. She lives in Bloomington, MN. She worked for the company for nearly 20 years, from 1978 to 1997. I know that Senator Wellstone would like to introduce Jane, so I will let him do that after I introduce the rest of the panel.

Karl Farmer, a former Polaroid worker from Lawrence, MA was an engineer with Polaroid for 30 years, retiring in September of 2001. He is now chairman of the Official Committee on Retirees from Polaroid Corporation.

Although not testifying, Betty Moss, a former Polaroid employee from Smyrna, GA is here today. Betty worked for Polaroid for more than 35 years. She drove all the way up here from Georgia, and I am grateful for her presence here today. I know that Reverend Jackson has been working with a number of Enron employees, and a number of us, Senator Daschle and myself and others, met with a number of them, and we are very appreciative of his strong work in their behalf.

We will also hear from James Prentice, chairman of Enron's Administrative Committee on the board of directors, charged with administering the Enron Corporation's savings plan, the 401(k) defined contribution plan. Mr. Prentice has been chairman of that committee from December 31, 1998 to the present.

We will hear from Professor Alicia Munnell, Peter F. Drucker Chair in Management Sciences at Boston College. Prior to joining Boston College, she was a member of the President's Council of Economic Advisors and Assistant Secretary of the Treasury for Economic Policy.

Dallas Salisbury is president and CEO at Employee Benefit Research Institute in Washington, DC. EBRI is a private, nonprofit, nonpartisan education research institute with respect to employee benefit programs. EBRI does not lobby and does not take positions on legislative proposals.

We are glad to have all of you, and we will start if we could with Mr. Lacey.

STATEMENTS OF STEVEN E. LACEY, PORTLAND GENERAL ELECTRIC EMPLOYEE, SALEM, OR; JAN FLEETHAM, FORMER ENRON EMPLOYEE, BLOOMINGTON, MN; KARL V. FARMER, FORMER POLAROID EMPLOYEE, LAWRENCE, MA; JAMES PRENTICE, CHAIRMAN, ADMINISTRATIVE COMMITTEE, ENRON CORPORATION SAVINGS PLAN; ALICIA MUNNELL, PETER F. DRUCKER CHAIR IN MANAGEMENT SCIENCES, BOSTON COLLEGE, BOSTON, MA; AND DALLAS SALISBURY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, EMPLOYEE BENEFIT RESEARCH INSTITUTE, WASHINGTON, DC

Mr. LACEY. Thank you very much, Mr. Chairman and members of the committee.

My name is Steve Lacey. I am from Salem, OR, and I work out of Portland General Electric as an emergency repair dispatcher. I have worked for this small utility for 21 years and am also a proud member of the IBEW for the same number of years; I started back in 1981.

The reason I am here is to tell you a little bit about what happened to us at Portland General Electric. Even though our lawsuit represents Enron and a full 21,000 people, some of us did not have the choice in our stock program. When Enron took over PGE, our stock was converted to Enron stock. At that time, our company—just to give you a little history about it—is a little different corporation. Enron came in and to us was like a Ferrari—very expensive, very fast, very flashy—it was a corporate world that we had never seen before. We were a very small, conservative, family-oriented company. It is not uncommon to have many members of a single family working—a lot of husband and wife teams. My own personal family has over 50 years of service for Portland General Electric.

The change there was like a media blitz to us. In the past, our 401(k) program was very conservative. Putting money in there was like putting money in the bank. You saved as much money as you could, you put your 30 years in, and you retired as best as you could.

Enron did a great job of selling their stock to us. Probably the most frequent people ask me is why did I put all my stock in Enron. It was very simple. It was good production. Educationally, they did not sit down and talk to us about any other options, where in the past, under Portland General Electric, we had very explicit options, none of which were very radical or risky, either one.

The other thing is that the executives of the company continually touted that our stock was undervalued, that at $80, it should be $120 and so on. So it was very easy to find yourself joining the bandwagon. I saw something that I had never seen before when I went to work, which was people checking their stocks every day. I had never seen this before Enron. There was a frenzy involved with it, that people were excited, and it was performing well, but we were basing our opinions and our own knowledge on some very false statements, as we find out now.

Most of us were 100 percent in Enron stock. Even to the end, it has been shown that the executives made statements repeatedly that everything was fine, do not worry about it. When we did come to the lockdown, and there was some controversy about the day

that it was actually frozen, I can attest that in the area that I worked—and I cannot speak for Houston or any other places—but in my company, as early as late September, we were unable to get into our website to do anything. And it is something that we are looking into right now in our own lawsuit.

So that effectively, we were locked out in late September. We made continuous pleas as the stock started to go down to help us out. Phone calls were not returned. We were told that the website was down because of different structural problems within, that it was not a lockdown as they called it.

When I filed the lawsuit, I think I did it more for my fellow employees than I did for myself at the time. It was like living through 1929 again. It was amazing to go into the building—I had been off for a few days and came back—and see good friends talking about the stock, and as I got up-to-speed on what had been happening, my losses were in excess of $100,000, which in Portland General Electric, as I talked to friends, was really very, very small comparatively. We average about 46 years of age in our company. To give you an example, in my job, there are nine of us trained to do this job company-wide. We work in a 24-hour emergency center. I am number seven on the seniority list at 21 years, just to give you an idea of where I stand. So that age and years of service in our company are very, very high.

I think one of the people who spurred to contact Hoggins Berman was probably one of my better friends whom I spent 16 years in the field with before I was injured. His name is Roy Rinard. Roy is in his early to mid fifties, was very close to retirement, and lost over $470,000. He is a very proud man, he is a hardworking man. I spent countless hours on Mount Hood, in the Gorge, in subzero weather, and he was one of those people who would work 20-hour shifts, day after day after day to get power back to people. There are countless others there as well. Roy also has three other family members who are members of Portland General Electric who lost their 401(k)'s.

The list goes on and on. The amount of money lost here was a phenomenal amount. For most of us age-wise, we are at a point where we are not going to be able to recover just because of our age and the number of years, unless we plan to work until we are 70. We are hoping that through speaking to you, we are able to convince people that this was not just a bad stock investment. Some people did some very bad things. They lied to us and quite possibly they broke the law. Hopefully, through working together, different groups and your panel, you will be able to come to a conclusion that we can make ourselves whole again, that we can have a future to look forward to.

I think most of our expectations are not real high. We want to be able to take care of our grandchildren. We want to have a decent retirement, maybe travel a tiny bit. I do not see us wanting mansions or resorts or anything like that. But the future right now is pretty bleak. Myself, I got married 2 years ago. The hardest thing I have ever done was to sit down and explain to my life that I had lost everything; and that is probably one of the few times I have ever really emotionally broken down and cried in my whole life. That was a tough night, and I will not forget it. And coming

back to work, looking around, seeing fellow employees—we have one gentleman at work who is very good with the stocks; it is a hobby to him, a business to him on the side, and a lot of people used him for advice because we did not have professionals available. We just had emails from executives telling us to buy, buy, buy, build the company, be a part of it.

He felt so responsible for the fact that he had convinced some others, including myself, to be 100 percent in Enron, that he was off on stress leave for a fair amount of time, and rightfully so. I spent quite a bit of time talking to him, too, away from work, and it was devastating to watch this man, too. He lost over $700,000 of his own money, but he felt very responsible for the others around him.

As I said, the crash was really devastating to all of us, and we are hoping that the recovery is aimed at this time. We hear a lot of talk about we want to change things to make sure it never happens again, and I have learned a lot today, sitting here and listening and understanding how the process works a little better. But I hope that the laws and the things that are being worked on may be able to come back and help the Enron workers—not that we are more special than anybody else who has lost money, but I think the reason we lost it—it was not a bad investment; I have heard a lot of reporters say, "Well, you made bad choices." Maybe we did. Maybe 100 percent is not correct. But like I said, in the culture I came out of in a very conservative company prior to Enron, that was not a bad choice at all. My father spent 30 years there, and as I said, I will probably put my 30 in as well.

I believe that this committee can do some things to help us. I am hoping that as the investigation finds those who are responsible that the punishment will fit the crime. I think one of the biggest things—even last night, I was receiving phone calls in my motel room at midnight wishing me luck, but also asking me to pass on that Enron made us believe that they were of the highest integrity. In fact, my boss, who is a middle management person, gave me a stress reliever that Enron passed on to him with the RICE program, which is Respect, Integrity, Communication, and Excellence.

Every person at PGE who was in middle management had something along this line, and I think most of us believed in it—not that it was new to us. I think we did it at Portland General Electric very well; for the past 100 years, the company has done very well. But all of this media hype was so important, and I think a lot of people took it to heart that there was no way that these people could mislead us or lead us down the road.

I appreciate the time that you have given me, and hopefully, we will be able to resolve this so it will not happen again.

Thank you.

The CHAIRMAN. Well, Mr. Lacey, speaking I think for the committee, we know how difficult it is to describe these circumstances, so we appreciate those who share them with us. I think that that is what this is really about—real families, real hopes and dreams that are lost, and real exploitation of the workers. We want to do what we can to remedy that, and we thank you.

[The prepared statement of Mr. Lacey follows:]

PREPARED STATEMENT OF STEVEN E. LACEY

Good morning Mr. Chairman and members of the committee. My name is Steven E. Lacey. I am 46 years old, and I work as an Emergency Repair Dispatcher for Portland General Electric's (PGE) Salem Division. As you know, PGE is a small utility in Portland, OR that is owned by Enron. I started with the company in 1981 and have worked hard for PGE for the past 21 years.

The reason I am here today is to tell you what really happened at Enron, from a victim's perspective. I am a second-generation employee at the company. Between my father and I, we have dedicated 51 years to PGE. This collapse has affected entire families. In some cases, several generations were all working at the company and devastated simultaneously. I want to tell you what my co-workers; and I experienced at our company and why I believe the system is broken.

First of all, you have to understand what type of company PGE was before Enron bought it in 1997. PGE has been in business for over 100 years. It was a very stable, local utility company that was run almost like a family business. PGE was very active in the community, and was a model of corporate and civic responsibility. Our stock price was steady, always within the $23 to $28 range. Putting your money into PGE stock seemed almost like putting it in a savings account at the credit union.

When Enron came in, it turned the company's culture upside down. Employees, and all Oregonians, were very skeptical of this fast-talking, Texas corporation. Comparing Enron to PGE is like comparing a Ferrari to a Volkswagen Bug. The Ferrari looks good, drives 240 miles per hour, but takes a lot of money to keep it running; on the other hand, the Volkswagen is practical, no-frills, cost-effective and pretty self-sustaining. The differences are striking. It took almost a year of negotiations and money in the form of "community investments" from Enron before the Oregon Public Utility Commission (OPUC) would approve the deal. When the sale was finally approved, our PGE stock was automatically converted to Enron stock one-for-one. We did not have a choice. When the conversion to Enron took place, none of the employees realized how different this corporation was and what kind of impact it would have on our investments. We know now, that our stock went from being a stable, predictable asset to a volatile, high risk gamble.

My 401(k) allocation was 100 percent Enron. I put the maximum amount possible (which was six percent of my pay) into the 401(k), elected to put that into Enron stock and received a matching contribution from the company in Enron stock as well. At that time, I did not think about retirement very often, since I was a younger worker and it seemed like a long way off. I was always told I should put as much as possible into my retirement plan because it was important for my future security. Our plan also prevented us from selling any of the company's matching stock contributions until age 50, so I didn't think much about trading, period. My shares of Enron stock are now worth next to nothing. I worked hard to save for my future and I have lost it all.

I have heard many stories that are even more devastating than mine. For example, Roy Rinard, age 53, has 22 years with PGE and had a $472,000 loss. He was hoping to retire early after many years of physically demanding work, but now cannot. Al Kaseweter, a lineman with PGE's Oregon City Division, is 43 years old, has 21 years with PGE and has lost $318,000. Dave Covington, age 42, has 22 years with PGE and lost $300,000. There are many more stories of folks who have delayed retirement or were going to finance their children's education with this money.

You may wonder why I chose to put all of my assets in Enron instead of diversifying. Well, the answer is simple. I was young, the stock was doing well, and all over the company, people said Enron was the best investment you could make. Words like "concrete" and "bullet-proof" were drifting through the halls of the shop as many folks watched the stock price climb in the late 90s. I did not follow stocks and investments like some people did. I just glanced at my statement quarterly when it came in the mail and went about my daily life.

Many employees followed the stock prices closely. When the value of our shares started to go down in April of 2001, and Ken Lay sold off millions of dollars in his own Enron stock, officials at the company would make excuses and ease our fears by talking about how the company was strong and the price would go back up. Also in April, Jeffery Skilling, then President and CEO of Enron, told employees that the stock was undervalued and would go up to $120 per share. This was also reported in The Oregonian (Oregon's statewide newspaper). On August 14, 2001, Ken Lay sent an email to employees stating, "Enron is one of the finest organizations in business today. Performance has never been stronger." On August 21, 2001, Ken Lay sent another email to employees expressing confidence that stock prices would continue to go up, which was also quoted in the Enron newsletter. So, as you see, the company officials kept encouraging us to hold onto our stock and never let on that

our company was in serious trouble. We thought we were all working together, helping to build our company and make it strong. Never did we think that this collapse could happen.

The most painful part of this whole ordeal was the feeling of helplessness during the lock down. As you know, the company made a switch in 401(k) plan administrators in, depending on whom you talk to, September or October 2001. This just happened to coincide with the company's announcement of a revised accounting statement detailing additional losses in revenue, followed by the most dramatic decrease in Enron stock value we had seen. In late September 2001, some PGE employees attempted to access their accounts to sell Enron stock and could not. Their account seemed to be frozen before the official date Enron said the lock down period would start. I, along with many other employees, tried to contact our plan administrator for help. Usually, an employee would either be on hold indefinitely, or if they did get through, they were told the system was temporarily down and to try again later. My belief is this—and I hope someone will investigate and verify my theory— that Enron froze out employees during this period to try to save the company.

The suffering people went through as they watched their futures crumble each day the lock down dragged on was unimaginable. It reminded me of the stock market crash of 1929. Our building was dead quiet. Everyone was in shock. Every computer terminal was logged on to an investment-type web site, as the news got worse. Emotions ranged from profound anger to unbearable grief and sadness. I could now understand why people jumped out of windows during the Great Depression, because we saw the effect it was having on our friends and co-workers right there, in front of us. One employee even left work on stress leave for an entire month. It was a brutal awakening.

This crash was devastating on all of us. We must bring the people who wronged us to justice. Why should the executives, who had prior knowledge of the hollow practices of the company, be able to escape with the millions they cashed out before the collapse and live happily ever after? Why should the hard-working people that literally built their company be left with nothing? We are pursuing a class-action lawsuit against Enron, in which I am the lead plaintiff. We believe we will win this lawsuit, but we don't want to end up losers in the long run. We may re-coup some of our losses through the liability insurance money the company kept on its officials, but even that won't make a big difference in the lives that have already been ruined. We must not leave these people behind by letting those who committed white-collar crime run off to some weekend prison with a putting green.

I believe this committee can do a few things to help us. We should make Ken Lay and other Enron executives personally liable for what they did to thousands of people. We must make it clear that there are serious personal consequences to deliberate corporate mismanagement. If you purposely deceive American working people, you will pay. We should pass a law that helps Enron workers recover immediately. We should send a message that, yes, this cannot and will not happen again, but also not turn our backs on the workers who are suffering now. If we cannot go after the millions these corporate executives made on the backs of hard working employees, then we should look to other reforms. I believe a law should be passed to address issues surrounding mandatory stock matches, total percentage of company stock in the 401(k) plan, and advance notice and limitations on the duration of lock out periods.

Thank you for allowing me to speak before your committee today on behalf of thousands of PGE employees.

The CHAIRMAN. I recognize Senator Wellstone to introduce Ms. Fleetham.

Senator WELLSTONE. Thank you, Mr. Chairman.

Mr. Lacey, as you were speaking, I said to Senator Kennedy that as far as I am concerned, this is absolutely the best place as I could be as a Senator, was to be here listening to what you said. I think this is the most important part of the testimony today.

Mr. Chairman, Jan Fleetham is a retiree from Northern Natural Gas, which is an Enron subsidiary, and she currently lives in Bloomington, MN. She worked for the company for nearly 20 years, if I am correct, from 1978 until 1997. She planned carefully for retirement, but is now struggling after losing most of her retirement assets, and the only other thing I would say is—and this comes from when we had coffee, Jan—she is a strong, levelheaded woman

who has been through a lot and has a powerful story to tell, and I think she is very, very, very determined that this not happen to other people.

Ms. Fleetham, thank you for being here.

Ms. FLEETHAM. Thank you for inviting me to be here. I have a written statement, but I do not do well with the written statement, so I am kind of going to do this on the fly, and obviously, if you have questions, throw them out.

I did work for Enron for almost 20 years. I started as a secretary, and through that 20 years worked my way up. I worked in Minneapolis, then Omaha, then back to Minneapolis, where I was working when I retired. During that time, it was without question the greatest job I have ever had, with the greatest opportunity. I had four children. I was a single mom. I raised my children. Three of my daughters were able to go through college. We lived a good life.

It was always encouraging that the benefits were great. I took college courses while working for them. We went to Omaha for 7 years, and that was a great experience, but it was nicer to come back to Minnesota, because I now had a grandchild there.

Over the years, I built up a retirement as best I could, with things going up. I put in some contributions as well as the company. The bulk of what I had was in company stock. I had it planned originally to work until age 62 and retire. I ended up taking early retirement in 1997, because it was either that or transfer to a region in Kansas, which I did not choose to do at that time, with my family being there.

When I originally left, I had approximately $2,000 total. I planned to use half of that, along with working part-time, to get through the 5 years until I was eligible for Social Security. My plan was that I would have $100,000 left after that time for any add-ons, any extenuating expenses that would not be covered by my part-time work and my Social Security.

Before I run out of time, I want to make sure I reiterate an experience with the lockdown I had. I had a problem with the lockdown, but it was not the same kind of problem everybody else had. I went on Social Security in June and decided I was going to sell about $10,000 worth of stock to get what I had caught up or paid off, and I was all set to fly then; I would have enough, and everything was working. I put a sell order in to sell the percentage of stock to come up with approximately $10,000 to $11,000 on October 9. On October 15, I received a letter in the mail that was dated October 8, telling me that there was going to be a lockdown, and it was going to begin on October 20, and it would last until November 19.

At that point in time, that was not a problem for me. I had gotten my sell order in before that, so the lockdown was not going to affect me, which in fact is what the letter said.

I got a confirmation notice on the request that had been there, but the withdrawal date was marked on the 30th of October, which was supposedly during a lockdown period so designated by the company.

I ended up getting a check with a distribution date of November 9, which was also within the lockdown period, and the check that was supposed to be for $10,000 was for $1,200. So at the time I put

in the order, the stock's value I am thinking was about $30 to $35. I would normally go $5 what it was at the time to figure out what I needed. Had they sold that stock immediately when I had put that in, I am sure I would have gotten very close to the value. Holding that for some reason until October 30, and supposedly during a lockdown, I obviously lost all but about 10 percent of that.

I question how that whole thing even worked. I am sort of stunned by it. So that actually, I am questioning if these people were allowed to sell their stock and did not have the lockdown, it would not have mattered anyway, because it looks to me like Enron sold my stock when they good and well felt like selling it—not when I put the order in.

So I think that is something to note when you are talking about lockdowns, that it is not always the lockdown that kills you. There has to be some kind of stoppage of a plan when you are changing administrators for computer work. But if it is not going to matter anyway, and the company can sell the stock whenever they want to sell the stock, that is kind of immaterial.

I am assuming there is really nothing that those of us can do. I would like to make one comment, though, addressing some of the comments he made with regard to the Enron employees, that you made a mistake, you did all of this, and it is your fault. To me, that is offensive, and it is kind of like calling the victim guilty of being raped because she wore a short skirt or she was in the wrong place at the wrong time. These people were not stupid, and these people did something—called it conditioning, call it acceptance, call it family—that they have been doing for a number of years.

Thank you.

Senator WELLSTONE. Just for clarification, Jan, if you do not mind, the $100,000 is now worth, right now, in terms of your own situation, just for the record——

Ms. FLEETHAM. Actually, I think, as of talking with somebody yesterday—it was worth about $600 when we had a meeting a while ago. I believe that as of yesterday, it is probably worth about $300, $400. I am hearing that the stock, at the price it was at yesterday, is probably worth about $300 to $400.

Senator WELLSTONE. From $100,000 to $300, which is kind of like Mr. Lacey's story.

Ms. FLEETHAM. Yes.

Senator WELLSTONE. Thank you.

[The prepared statement of Ms. Fleetham follows:]

PREPARED STATEMENT OF JAN FLEETHAM

Thank you for inviting me to speak here today. My name is Jan Fleetham and I am from Bloomington, Minnesota.

I am a retiree who worked for almost twenty years for a company, originally known as Northern Natural Gas, a company that eventually became the Enron Corporation. I started out in 1978 as a secretary in the Data Processing Department in Minneapolis, Minnesota, making roughly $700 a month. By the time I retired in 1997 I had risen to the position of microcomputer analyst for the Northern Region and I was earning a salary of $60,000.

I worked hard for this company for twenty years. I saved and planned as carefully as I knew how for my retirement. But now Enron's collapse has made all of that meaningless. My dreams for a secure retirement have been gutted and the next few years will be a huge struggle for me financially.

Over the years I built up a retirement fund that included my contributions as well as the company's. I used some of the funds in this account over the years but planned carefully to have a balance left upon my retirement so that I would have sufficient resources.

Now, the balance in my retirement account of $100,000—all in company stock—is worth $600. As a single woman of 62, instead of looking forward to enjoying time with my children and grandchildren, I will now have to work many hours to supplement my social security and a small annuity of $200 per month I have from before Enron took over my original company.

While my company is in the process of reorganizing I am told that my health benefits will continue. However, if the company fails, then I will lose those benefits. Given my current situation, like most retirees, I cannot possibly afford to get my own coverage.

What is particularly troubling to me is that I had no reason to think that my retirement fund was not secure. I read the annual reports from the company, but I was never very sure what I was supposed to get out of them. Everything looked fine to me. As far as I was aware, there was never a hint of a problem, not from Enron, their auditors, nor from the financial community at large. Virtually all Enron employees were completely blind-sided when this happened.

When I had the opportunity to choose where to put the funds, in my account, I chose the company stock. The company gave me choices that included the Enron Corporation Income Fund, seven Fidelity funds, Enron Corporation Stock, and Enron Oil and Gas stock. All of my account was invested in Enron. At the time, I did not see the good in abandoning the high returns that my stock had been providing in favor of one of the far lower anticipated returns of the alternatives offered.

With hindsight, it appears clear to me that I could have spent more time and energy looking at what was going on within the company. However, I doubt I would have been knowledgeable enough to pick up on the problems seeing that a noted auditing company supposedly also failed to recognize any problems. As an employee, I felt like I knew what was going on within the company, though looking back, this was clearly not the case.

I certainly don't feel the company was very forthcoming about their—or my—situation. When the stock went public, I received mailings that offered me the opportunity to buy additional company stock. I also recall that since my retirement, I received solicitations from Enron for me to purchase more of their stock. Nothing in these solicitations made me think there were any problems at the company. If anything, they made me think that the company was prospering.

As did other employees, I also had problems this fall when I tried to sell some of the stock in my retirement account. During the fall I wanted to withdraw $10,000 worth of stock. On October 9th, I submitted an order to sell. I specifically checked a box on the order form so that the sale would be executed as soon as practicable. In the past, this meant that the stock would have been sold within 7 to 10 days.

I received a notice on October 15th (the letter was dated October 8th) saying that I would be unable to access my account from October 20th to November 19th. This was the so-called "lockdown period" that we've heard so much about.

I did not think this was a problem because I had put in my sell order before October 20th and the sale should have been completed by then. For some reason, however, the confirmation I received stated the withdrawal date as October 30th—during the supposed lockdown period. Ultimately, I received a check with a distribution date of November 9th for roughly 10 percent ($1200) of what I had calculated the stock was worth at the beginning of the previous month. The number of shares that were valued at more than $10,000 at the beginning of October were worth only $1200 by the time they were finally sold.

Enron's collapse has wiped out my retirement savings. I don't know if anything can be done to help me or other Enron employees who have found themselves dropped into such unexpectedly dire straits. But I do think that if anything can be done to prevent this from happening to other workers in the future, it is important that you take immediate and decisive action.

The CHAIRMAN. Karl Farmer, a former Polaroid worker from Lawrence, MA, worked for Polaroid for 30 years and is chairman of the Official Committee of Retirees.

We are glad to have you here.

Mr. FARMER. Good morning, and thank you, Mr. Chairman and committee members.

As you said, I am a former Polaroid employee and chairman of the Official Committee of Retirees of the Polaroid Corporation. I am accompanied by counsel of the Official Committee, Al Gray of Greenberg Traurig, and as well, Betty Moss, another former Polaroid employee.

I am 55 years of age. I was born and raised in Roxbury, MA and spent a lot of time in Medford and Bedford, MA, and just recently moved to New Hampshire.

The CHAIRMAN. Did you say you are 55 today?

Mr. FARMER. No. Last week, the 28th.

Senator WELLSTONE. My mistake. I am sorry.

Mr. FARMER. The 28th—which is part of the issue of a change for me. I was a severed employee who was severed into retirement age, which makes me what they call a "crossover."

I started working for Polaroid around 30 years ago as an engineer, and just recently, in September, left because my job went away, and I took the opportunity to take that severance into retirement, if you will.

At the time I started at Polaroid, Polaroid was one of the companies to work for. It was an especially good company for minorities because it was very progressive. They were doing affirmative action programs before they were mandatory and fashionable, and it was a family kind of company with an upper management that was a caring group of guys.

Up until 1988, I had begun to put some savings, 2 percent of my pay, into a 401(k) account. Polaroid did a matching dollar for dollar on that account, and it was such that I was able to add to what I thought was going to be a nice retirement nest egg.

But in 1988, Polaroid started a mandatory ESOP, and that was a plan which required the employees to take an 8 percent pay cut to help finance the plan. And where most ESOP plans did not require workers to contribute, this one did, and the reason was because it was an ESOP to prevent a hostile takeover. What really meant was that it prevented the management structure from being thrown out, if you will, so it really was an entrenchment of the management in the corporation.

But as I said, they were at that time what we thought were decent individuals, fair, and we thought they were doing the right thing for the corporation and for us, so we bought into that ESOP—naturally bought into it, because we had no choice.

As a result, because of the cost—I had three sons, I had just bought a new house recently—I was not able to continue to put the money into the 401(k), not have it matched, and also pay for the ESOP with that pay cut, so I had to stop doing that 401(k) part of the investment, if you will.

So I did not really realize the danger that was to follow in diversifying the retirement account until August of 2001, when I was told that my job was being eliminated. I was promised that severance package, as I mentioned, which included medical and dental insurance coverage at employees' prices, which seemed like a good thing to do, for 6 months along with 6 months of severance pay. This transition period actually took me into retirement, where I could count on what I thought was a nice ESOP and pension plan.

The day I was to receive my first severance pay, I called and asked whether it was going to be deposited into my checking point or whether I was going to get a separate check. I later learned that people were not receiving their checks that day, and there was some issue going on.

The next day, Polaroid declared Chapter 11. As a result, Polaroid stopped paying the severance and they also stopped paying the medical, dental, and insurance benefits to retirees and severed employees. I did not find this out right away. It was a couple of days later, after calling, that I found that out.

With that loss, I ended up having to break a lease and vacate my apartment, because I was on unemployment, did not have a job, and I had to act very quickly, because this happened very, very quickly to me. There was no advance notice. So I was pretty—also, I had to default on—I had two 401(k) loans that were outstanding, and I asked what the penalty on that was, and they said, well, you do not have to pay them off, but it is going to detract from what you will get in your retirement stage. So instead of taking that financial burden, I stopped doing that.

As for the ESOP plan, I had about 3,500 shares which at the peak were worth about $210,000. Now, without asking and without knowing, the trustee of the account sold off the shares at 9½ cents a share, which was about $332 or something like that.

So if I look at the ESOP loss and the severance loss and the fact that I now have to pay the medical, it is about a quarter of a million dollars' loss to me, which I think is very unmanageable.

The other part of that is the ESOP shares. When I left the company, my assumption was that I owned those shares of stock, because I was no longer an employee, and it says ESOP, which means employee stock ownership plan. I was not told that I had to sell those shares or move those shares in any way, shape, or fashion, or they would be treated like the rest of the ESOP shares. But that is in fact what happened. If you do not tell them that you want to move them, they keep those shares and treat them as the other ESOP shares.

What else do we have—many of us cannot understand how the trustee of the retirement plan can actually do that and call selling the shares in the letter we received "in the best interest of the employees" and wait until the shares go from $20 to $10 to $5 to $3, and then wait until it gets down to 9½ cents and act in my best interest. I think that is ludicrous in a big way.

The other thing that it does is because the ESOP was to protect a hostile takeover, it takes 15 to 20 percent of ownership of the company out of the hands of the employees, so that now we do not get to vote on anything.

For me, one of the reasons why I am here and one of the reasons why I am the chair of the committee—Betty Moss who is with me today wrote a letter to the bankruptcy judge announcing what was going on, and it kind of inspired me. I also wrote a letter to the judge and also talked with Al Gray, one of the counsel who happens to be my brother-in-law, and we got together and talked about what is it that we can do to try to offset what happened. I was really looking for what I could do personally to regain what has happened to me. And to make a long story short, we finally got a group

of people together and talked about what the issues were for everybody, and Greenberg Traurig came in and said "We can provide some assistance to you through the court in the fashion of being recognized by the court, starting out as an ad hoc committee and then an official committee." And this was done.

The problem I have with the system is that we did not know that. When we try to get people together as a group, we do not understand who the people are that are laid off. There are no lists. You do not know where the folks are. It is not like you let one particular building go or division. So it makes it very, very hard to unite in a fashion to try to stop the bleeding, and that is what we ended up doing. So it was almost pure fate that Al and I happened to get together and be able to work together to start this committee to stop that.

As we have proceeded along—and I would like to thank the offices of Senator Kennedy and——

The CHAIRMAN. Excuse me, Mr. Farmer, but if you will look behind you, there are some little light up there, which means there is a vote. That is why Senator Wellstone had to go over there. So we will have to recess momentarily, but he will return, and we can move ahead with the hearing.

I have had the good opportunity to meet on two different occasions with a number of the workers. You could have put Polaroid on the list of outstanding companies that we heard earlier today. Ed Land, who worked in the Defense Department in the early 1960's, at the time President Kennedy was President, went back up to Cambridge and was a genius, an absolute genius, in inventing the Polaroid camera, the instant camera, worldwide. He was an absolute genius.

Mr. FARMER. He held the second amount of patents.

The CHAIRMAN. It was unbelievable. Polaroid was well run, had the respect of everyone in the State and all the financial institutions. And we will not go into some of the difficulties they have had with different kinds of competitive situations, but you could put them right at the top of that list that Senator Corzine showed us, and now, what has happened to all those, as you have described here, hard-working people who devoted their lives to that company, were resourceful and creative individuals who were well-informed, well-educated individuals. It does not make any difference as far as people who are losing; you are talking about people who have just been left high and dry, and that is the Polaroid situation.

We have seen it again and again and again, and that is the reason we have to ask ourselves if we are just going to let this kind of system, with some minor adjustments and changes, continue, or are we really going to deal with the question, and the more I hear, the more I am a strong believer in the importance and significance of diversity.

We will recess for just a few moments and then continue.

[The prepared statement of Mr. Farmer follows:]

PREPARED STATEMENT OF KARL V. FARMER

Good morning. My name is Karl Farmer, and I am a former Polaroid employee and chairman of the Official Committee of Retirees for Polaroid Corporation. I am also accompanied today by counsel for the Official Committee of Retirees, Scott

Cousins, of Greenberg Traurig, as well as Betty Moss, another former Polaroid employee.

I am 55 years old. I have lived in Roxbury, Medford, Bedford and Lawrence, Mass., and I recently moved to New Hampshire.

I started working for Polaroid more than 30 years ago as an engineer and became a retiree after I left the company on September 29, 2001. At the time I started with the company, Polaroid was one of THE places to work. It was an especially good company for minorities, very progressive. Polaroid was doing affirmative action programs before it became fashionable or mandatory. It was a family company with a caring upper management.

Up until 1988, I had begun to save for my retirement by contributing 2% of my pay to the Polaroid 401(k). Polaroid matched that contribution dollar for dollar so that I was able to start building for my retirement with a diversified retirement plan.

But in 1988 Polaroid started the mandatory ESOP plan which required employees to contribute 8% of their pay to the ESOP plan. I had always understood that most ESOP plans did not require workers to contribute to them, but Polaroid required that we contribute to this one.

Because of the mandatory requirement that we contribute to the ESOP, I was no longer financially able to contribute to my 401(k). As a result, my retirement was then tied up almost exclusively with the ESOP and Polaroid stock. I have not figured out how much money I would now have if I had continued to contribute to my diversified 401(k) instead of the ESOP, but I am meeting with a financial advisor from Fidelity next week, and I'm sure they'll be able to tell me the bad news.

I didn't really realize the danger of not being allowed to diversify my retirement account until August 2001 when I was told my job was being eliminated, and I was promised a severance package, which included medical, dental and life insurance coverage at employee prices for six months, along with six months severance pay. This transition period actually took me to retirement—where I could count on my ESOP and pension plans.

The day I was to receive my first severance payment I called to verify that it was being deposited. I later learned that many people who were supposed to receive severance payments that day did not, and the next day Polaroid declared Chapter 11. As a result, Polaroid is not paying my severance, or providing the medical, dental or life insurance it had agreed to. I have been left unemployed with no benefits. I had to break a lease and vacate my apartment. I had also taken out two loans on my 401(k) plan, and I will now be unable to pay those back. As a result, I'm also going to be hit with a huge tax penalty for making withdrawals on my 401(k).

As for my ESOP plan, I had 3500 shares which, at their peak, were worth about $210,000. Without asking me, or apparently anyone else, management decided to liquidate these shares for about $300.

We learned, after the fact, that State Street Bank & Trust, the trustee of the fund, started liquidating Polaroid's ESOP shares in mid November 2001, and completely liquidated the fund by mid-December 2001. After the liquidation was complete, Gary DiCamillo, Polaroid's current CEO, sent out a letter on December 10, 2001 to all employees notifying them that "it was in the best interest of participants in the ESOP fund to liquidate all shares."

Many of us cannot understand how the trustee of a retirement savings plan acted "in our best interest" by selling the ESOP stock when it reached 9 cents a share. Not only that, the liquidation of those shares means the "employee owners" have almost no influence. We used to own almost 20% of the company. Now we cannot even vote on the Polaroid bankruptcy and related matters.

We decided to try to influence the process, even if we were disenfranchised former owners of the company. It took a big effort to pull folks together to fight for what's been promised. People are scattered and we do not have lists of everyone who has been affected. Still, we organized. I'm the chair of the Official Committee of Retirees of Polaroid, which was recently recognized by the bankruptcy court. This allows us legal representation with the bankruptcy proceedings.

The offices of both Senator Kennedy and Representative Delahunt have worked very diligently with us in our fight for justice. And recently a letter was sent to Polaroid's CEO from the entire Massachusetts Congressional delegation denouncing Polaroid's actions. Our committee and its constituents thank you and the other members of the Massachusetts delegation for those clear signs of support. In the same spirit, we urge you to change the rules on ESOP programs to allow employees some control of their own destiny.

Thank you.

[Recess.]

Senator WELLSTONE [presiding]. The HELP Committee will be back in order.

We will start with Mr. Prentice, then Alicia Munnell, and conclude with Dallas Salisbury, if that is okay.

Mr. Prentice, thank you for being here. And I apologize to all members; we just had a vote, and that was the interruption.

Mr. PRENTICE. Good afternoon. My name is Jim Prentice. I was trained as a chemical engineer and currently hold the position of senior vice president of liquids operations at an Enron affiliate, EOTT Energy. My current duties include management of the company's petrochemical facilities. I have been with Enron or one of its predecessor companies for 31 years.

I was asked to appear before you today in my capacity as chairman of the Administrative Committee of the Enron Savings Plan or the 401(k) Plan, as it is often called. I have been on that committee for over 10 years, and I have served as chairman of the committee for the past 3. I am here today voluntarily to address issues surrounding Enron's 401(k) plan; however, I cannot address what went wrong with Enron, and I cannot address the larger financial and accounting issues that have been raised. My knowledge of those issues is limited to what I have learned from the media.

First, a few words about the Enron savings plan itself and the investment options. The plan is a vehicle by which employees can supplement their retirement savings by electing to defer from one to 15 percent of their compensation, pre-tax, to an individual retirement account. At present, employees have total choice over the manner in which those savings will be invested.

In this regard, the plan permits participants to allocate their funds among 20 separate investment options and to make changes if they so desire on a daily basis. One of those options includes the ability to invest in Enron stock. It is my understanding that this feature was included from the very beginning as part of the plan design. Other options include a stable value fund and a variety of fixed-income and equity funds of varying levels of risk and potential reward. Finally, employees are free to entirely self-direct their investments through a separately maintained investment account such as Charles Schwab.

As the committee is also aware, over the years, Enron has also made a matching contribution of company stock to participants in the savings plan. This matching was reinstituted by the company in 1998, and as a matter of plan design, the matching Enron stock was restricted. Employees were not permitted to shift the match from Enron to other investment options until they reached the age of 50.

Second, I would like to briefly comment on the Administrative Committee. The committee is generally charged with overseeing the administration of the savings plan. Its members are appointed by the company and serve without compensation. The committee effectively operates and functions like a board of directors. In performing its duties, it is ably assisted by the Enron Benefits Department. That department is responsible for the day-to-day details of plan management and administration. The committee is also assisted by professional investment consultants and legal counsel.

Throughout my tenure on the committee, it has typically met on a quarterly basis, with additional and more frequent meetings as circumstances require. The principal focus of the committee's meetings has been on investment-related matters, such as monitoring the performance of the investment managers, and on the handling of any participant benefit appeals that may arise.

Specifically with respect to the savings plan, we viewed our charge as assuring that adequate investment options were made available to the participants for the diversification of their accounts. However, the choice of those investments as among all those vehicles was always with the participants.

This concludes my statement. I look forward to your questions.

Senator WELLSTONE. Thank you, Mr. Prentice.

Ms. Munnell?

Ms. MUNNELL. Senator Wellstone I am delighted to have the opportunity to talk about reforming the pension system in the wake of Enron. I am afraid my comments are going to seem a little dry after the losses that we have heard suffered by the rest of the panel, but my hope is that we can make changes so that such tragedies do not happen again in the future.

Since the focus of today's hearing is Enron, I will devote most of my comments to the immediate problem of diversification and employer stock. But I would also urge you in future hearings to look at other aspects of 401(k) plans and at the pension system more broadly. 401(k) plans have exploded in the last 20 years, and I think it is really time to look carefully at both their strengths and their weaknesses. It has become absolutely clear that the current voluntary employer-based pension system is never going to cover about 40 percent of all workers, and we should think of some other mechanism to solve that problem.

With regard to 401(k) plans in the wake of Enron, I would like to make four points. First, the need for diversification argues strongly for putting some limits on holding of company stock.

Second, restrictions on selling employer stock should be eliminated.

Third, the question of "advice" bills raises a broader issue of whether we want to the average person to become a financial guru or whether we want to make investment in 401(k) plans simpler. I would argue for simpler.

Finally, for those who argue that we are trying to take away freedoms, I want to emphasize a point made by Senator Corzine, that these restrictions are limited to the tax-subsidized, employer-provided pensions, and they are limited to vehicles that are aimed at providing retirement income.

Starting with the overinvestment issue, overinvestment in employer stock is not prudent. Not only are participants investing in a single stock instead of many stocks, which raises their risk, but they are also putting their investments where their earnings are. Such concentration only increases risk and has no possibility of increasing returns. Enron highlights the problem, but as people have said all day long, Enron is not the only case—many large companies have much greater concentrations.

Also, Enron is not the only company that has both had its stock collapse and its employees lose jobs at the same time. We have had

Lucent, we have had Polaroid. Arthur D. Little in Boston yesterday declared bankruptcy, and its retirement plan is tied up with employer stock.

The question is what to do. Senator Boxer and Corzine have suggested limiting employer stock to 20 percent. That would solve the diversification issue, but it does involve the question of coming in and forcing employees to sell, perhaps just as their employer stock has taken off.

Another option is to put the limitation on contributions, limiting contributions to 10 percent both on the employee and employer side, or my preferred solution would be that if the employer provides employer stock as the match, just prohibit the employee from investing his or her contribution in employer stock, or just, plan prohibit employees from investing in common stock.

The second issue with regard to employer stock is restrictions on selling. Again, I think this makes it very difficult for employees to diversify. These restrictions should be eliminated. The President's proposal on this sounds pretty good if it really means what it says, which is that as soon as you are vested, after 3 years, you can sell your employer stock, and if you get it 5 years later, you do not have to wait at all; you have made this hurdle of a vesting period, and you can sell at will.

The third issue that has arisen—or, re-arisen, I guess is the way to describe it—in the wake of Enron is the question of "advice" for employees about their investment decisions. Right now, employers can and do educate their workers, both on the necessity to save and on some rudimentary financial issues. But those who support outside advice have something more extensive in mind. Essentially, they want outside advisors to be allowed into the workplace to advise employees on their investment decisions.

While at first blush, it may seem strange to question the desirability of investment advice, I think it raises a fundamental issue about how difficult we want the investment decisions faced by the typical worker to be. My view is that 401(k) investing is simply too hard, and we should make investment easier rather than turning employees into investment experts.

One way to solve the problem would be to provide tiers of options. It would be wonderful if employees enrolling in a 401(k) plan were told that one of three alternatives meets the needs of most workers—low risk, medium risk, or high risk packages. The employee would then answer a few simple questions to determine his or her risk tolerance and sign onto one of these packages that would be rebalanced over time, graded with their age, and they would never have to think about it again. They would not be checking the value of their stock every day. End of story.

These packages would have Labor Department approval as prudent—of course, with no guarantee of return—and employers who offer these low, medium, and high packages would not be at peril of litigation. The more sophisticated investor could say, "Those are not for me; I want to have 20 options from Fidelity and 20 from TIAA-CREF," and they could have them, and the more daring could have brokerage accounts.

This tiered series of options, with the simple packages up front, is not something I wish for other people. It is something that I

would like for myself. It sends a message that people do not have to become investment experts. They can coach their kids' soccer team, they can read a book, they can play tennis—they can spend their lives doing normal, regular things.

Enacting legislation that enables outside managers to enter the workplace to offer advice sends a very different message. It says: "Investing 401(k) funds is a difficult task, and you had better study up."

So that while I support some form of mandatory diversification for 401(k) plans, I think it is the most important thing to do and an end to forced holding periods. It is not clear to me that the proposed movement from education to advice is good for workers generally.

Thank you.

Senator WELLSTONE. Thank you very much.

Mr. Salisbury?

[The prepared statement of Ms. Munnell follows:]

PREPARED STATEMENT OF ALICIA H. MUNNELL

Chairman Kennedy, Senator Gregg and Members of the Committee, I am delighted to have the opportunity to testify today on the difficult issue of reforming 401(k) plans in the wake of the collapse of Enron. Since that is the focus of today's hearings, I will devote most of my comments to the immediate problem of employer stock and diversification. But I would also urge you in future hearings to look at other aspects of 401(k) plans and at the pension system more broadly. It is time to assess both the strengths and weaknesses of 401(k)s, and to consider ways to broaden pension coverage generally.

With regard to 401(k) plans, let me make the following points.

- First, the need for diversification argues strongly for placing some limits on investments in employer stock in 401(k) plans,
- Second, restrictions on selling employer stock should be eliminated.
- Third, the question of "advice" raises a broader issue of whether to make the average employee into an investment expert or to simplify 401(k) investment options.
- Finally, I want to emphasize that this discussion is targeted not at investments generally, but at investments in tax-deferred savings vehicles aimed to provide retirement income.

With regard to more general concerns about 401(k) plans, voluntary participation and contributions have meant that 25 percent of those eligible do not participate and only 5 percent of participants contribute the maximum. Similarly, lump-sum payments have encouraged younger workers to cash out when changing jobs and have left retirees with the tough decisions about how to spread their money over their retirement years. All these problems could be helped with well-designed default options.

On the very broad issue of pension coverage, I would argue that expansion of the employer-based system is both unlikely and probably not the best way to provide additional retirement income for those at the lower end of the earnings distribution. It is time to face this fact and to consider alternative ways to provide additional retirement income for lower-paid workers.

Let me elaborate on each of these points for a moment—starting with the immediate Enron-related issues—and suggest some possible approaches for addressing the problems.

I. Reforming 401(k) Plans in the Wake of Enron

Enron raises three immediate issues about 401(k) plans. How much company stock should be held in 401(k) plans? How long should employees be required to hold that stock? And how much "advice" should employees be provided?

Over-Investment in Employer Stock

Over-investment in employer stock is not prudent. Not only are participants concentrating their assets in a single stock, which is more risky than a diversified portfolio, but they are investing in a security that is highly correlated with their own

human capital. Such concentration raises the risks to employees with no comparable increase in expected returns.

Enron highlights a major problem of over-investment in employer stock. As of December 31, 2000, 62 percent of the assets in Enron's 401(k) consisted of Enron stock. But Enron is not alone. A recent study showed a number of large companies with even greater concentrations—Procter and Gamble (94.7 percent), Sherwin Williams (91.6 percent), and Pfizer (85.5 percent) to cite a few.

Moreover, Enron is not the only company where employees lost their pension saving and their jobs simultaneously. In the past year, financial woes have erased billions in pension accounts at Lucent Technologies, Polaroid, and other companies just as these woes forced massive layoffs.

The question is what to do. I would argue for some mechanism that limits investments in company stock within the 401(k). Senators Boxer and Corzine have suggested limiting 401(k) holdings of any stock to no more than 20 percent of total assets. This proposal achieves the diversification goal, but it may well require employees to sell employer stock just as it takes off. An alternative option is to limit both employee and employer contributions to 10 or 20 percent of the amount they are contributing. This would help diversification, but would be less than perfect if the stock did very well and employees did not rebalance their portfolios. Another alternative would be to prohibit employer stock as an investment alternative for employees if the company made its matching contribution in employer stock. No option is perfect, but selecting one is superior to the current practice of allowing employers and employees to load up 401(k)s with employer stock.

Selling Restrictions on Employer Stock

The second aspect of employer stock is the holding period. Employers who contribute company stock as a matching contribution to 401(k) plans often place restrictions on selling that stock. These restrictions take the form of an age limit, such as 50 in the case of Enron, or a requirement that employees hold it for a certain period of time, such as 5 years. But again, Enron is not alone. Hewitt Associates reports in a recent study that only 15 percent of firms that match with employer stock allow their employees to sell immediately. A study by Fidelity Investments found that only 4 percent permitted immediate sale (Purcell 2002).

These holding restrictions limit the ability of employees to diversify their portfolio and should be eliminated. One proposal offered by a working group of the Pension and Welfare Benefits Advisory Council (1997) recommended that employees should be able to sell their employer stock once they become vested in the plan. Since the maximum period for cliff vesting of employer contributions in 401(k) plans is 3 years, one obvious proposal would be to allow employees to sell their stock immediately upon receipt once they had been in the plan for 3 years. Just to be clear, the 3 years is a onetime threshold to satisfy vesting, after employees cross that threshold they can sell their employer stock at will.

Is "Advice" the Answer?

A third issue that has arisen—or re-arisen—in the wake of Enron is the question of "advice" for employees about their investment decisions. Employers can and do already provide education about the importance of retirement saving and the rudiments of investment options. Certainly, educating employees about the need for diversification and the risks of concentration is also an important goal, and perhaps employers should be required to provide employees with such a statement, particularly if they match with employer stock.

Those who support outside advice have something more extensive in mind. Essentially, outside advisers would be allowed into the workplace to advise employees on their investment decisions. While, at first blush, it may seem strange to question the desirability of investment advice, I think it raises a fundamental issue about how difficult we want the investment decisions faced by the typical employee to be. My view is that 401(k) investing is simply too hard, and we should make investment easier rather than turn employees into investment experts.

One way to solve the problem would be to provide tiers of options. It would be wonderful if employees enrolling in a 401(k) plan were told that one of three alternative investment packages—low risk, medium risk, or high risk—meets the needs of most people. Employees simply answer a few questions to determine their risk tolerance and select one. End of story. These packages would have Labor Department approval as prudent—of course, with no guarantee of return—and employers who offer these low-medium-high packages would not be at peril of litigation if the results were unfavorable.

The more sophisticated investor or someone who wanted to participate more actively could ask for a second level of options with an array of funds from one, two,

or even three providers. The truly daring could push even further for a brokerage account of some sort.

This tiered series of options with the simple packages up front is not something I wish for other people; it is what I would like for myself. It sends a message that people do not have to become investment experts, they can coach their kid's soccer team, play tennis or read a book instead. Enacting legislation that enables outside managers to enter the workplace to offer advice sends a very different message. It says "Investing 401(k) funds is a difficult task, and you better study up."

Thus, while I support some form of mandatory diversification for 401(k) investments and an end to forced holding periods, I think the proposed movement from education to advice may send the wrong signal.

Justification for Restrictions on 401(k) Investments

Finally, let me respond to those who claim that mandatory diversification unfairly restricts employees' freedom. First, it is important to remember the limited and targeted nature of the proposed provision. It is not aimed at employees' investments generally—although diversification is always a good idea—but rather at investments in a tax-favored retirement program. Although 401(k) plans emerged somewhat accidentally, the Federal government has contributed substantial resources in the form of foregone revenues to their growth and success. These resources were contributed to ensure that workers would have a second layer of protection in retirement beyond Social Security. 401(k) plans cannot succeed in their mission if employees put all their eggs in one basket. If employees want to make imprudent investments, they should have to do it outside of the subsidized pension system.

Moreover, mandatory diversification is not the first restriction put on 401(k) investments. Employees cannot withdraw money from 401(k) plans without penalty before age 59½, and can withdraw only for designated purposes. Mandatory diversification is aimed at the same goal; ensuring that employees have the best chance for a secure retirement.

Finally, the benefits of diversifying pension fund investments have already been recognized under ERISA. Current law limits employer stock to 10 percent of the portfolio in conventional defined benefit pension plans. The diversification proposal simply extends the protections to defined contribution plans.

II. Improving Pension Benefits in 401(k) Plans

Let me move from the issue of employer stock to other troublesome aspects of 401(k) plans. Whereas 401(k) plans have some great strengths—they allow greater portability for mobile workers, they do not encourage early retirement, they provide a sense of ownership and control—they also create several types of problems that do not arise with conventional defined benefit plans. The reason is that 401(k)-type plans shift a substantial portion of the burden for providing for retirement to the employee; the employee decides whether or not to participate, how much to contribute, how to invest the assets, and how to withdraw their funds each year during retirement.

Optional Participation and Contributions

Roughly 25 percent of those covered by a 401(k) plan elect not to participate, and only 5 percent contribute the maximum. Part of the behavior can be explained by the characteristics of workers themselves. Participation and the level of contributions tend to increase with the income, age, and education of the employee (Andrews 1992, EBRI 1994, and Bassett, Fleming, and Rodriguez 1998). People with longer planning horizons—and presumably more interest in their retirement—also are more likely to participate and contribute (Munnell, Sundén, and Taylor 2000).

Plan structure and characteristics also are important. If employers offer a match, workers are more likely to contribute. This is not surprising since the match provides a large initial return that supplements the advantage of deferral. It is not clear, however, whether employees respond to the level of the match rate once a positive match is provided. In addition, workers are more likely to participate and contribute if they can gain access to their funds through borrowing. On the other hand, workers are less likely to participate and contribute if they are also covered by a defined benefit plan, and the more generous the defined benefit plan, the less likely participation.

What can be done to improve participation and encourage contributions? First, the fact that individuals' planning horizons are an important determinant suggests that education about the importance of planning for retirement should improve both participation and contributions. In fact, studies have shown that employer-provided information can be very important in changing employees' attitudes about the necessity of saving (Bernheim 1998 and Clark and Schieber 1998).

Second, research indicates that individuals' behavior often reflects a surprising amount of inertia, and that if employees are automatically enrolled in a plan, they are more likely to participate than if they had to opt in (Madrian and Shea 2001). In 1998 and 2000, the IRS issued regulations that permit employers to enroll employees automatically in 401(k)-type pension plans. Since the IRS issued its first regulation, about 10 percent of 401(k) plan sponsors have adopted automatic enrollment (Jacobious 2000 and Purcell 2001). A recent study found that although automatically enrolled employees could opt out of the 401(k) plan, very few chose to do so (Choi et. al. 2001). In short a combination of education, automatic enrollment, and high default contribution rates is likely to increase participation and future benefits.

Lump-Sum Payments

The second problem with 401(k) plans is that they generally offer benefits as lump sums rather than as annuities. Lump-sum payments make it difficult for retirees to figure out how much to withdraw each year. The risk is that retirees either spend too quickly and risk outliving their resources or spend too conservatively and underconsume.

Fortunately, a product exists that removes the risk of outliving resources or the problem of lost consumption opportunities. A life annuity allows retirees to exchange a pile of wealth for a stream of income that will be paid as long as the retiree lives. Such payments ensure that retirees will not outlive their resources. They also encourage retirees to spend their accumulated funds and in fact provide a higher level of income than retirees could receive in the absence of annuitization, in exchange for making the receipt of income contingent upon living. Unfortunately, according to the Employee Benefit Survey for Medium and Large Firms, in 1997 only 27 percent of 401(k) plan participants had an option to choose a life annuity as their method of distribution and that percentage is likely to decline in the future.

Of course, retirees could withdraw their money as a lump sum from the plan and then purchase an annuity from an insurance company. But this rarely happens. Recent research has suggested a number of reasons why retirees do not purchase annuities. First, annuity prices are not actuarially fair; the company needs to cover administrative costs and profits, and those with longer life expectancies are more likely to buy the product. In fact, the net present value of future annuity payments for a 65-year-old male in 1995 was about 80 percent of the required premium; 10 percent was due to mortality differences and 10 percent due to administrative costs (Mitchell et. al. 1999). Second, people may want to leave a bequest, which would reduce the incentive to annuitize at retirement. Third, families may provide a certain amount of self-insurance among themselves. Fourth, people may not want to give up flexibility if they are concerned about future expenses, such as uninsured medical expenses or long-term care. Finally, people appear not to understand the benefits of annuitization; they tend to focus on the risk of dying early and receiving less than they paid in and ignore the possibility of living longer than expected and receiving much more than they paid (Brown 2000).

Given the low likelihood that people will annuitize on their own, the form of distribution from 401(k) plans becomes very important. My view is that annuities—preferably a joint and survivor annuity—should be the default option in 401(k) plans. This would force the participants to affirmatively select an alternative distribution option. Given the importance of inertia, making annuities the default would almost certainly increase annuitization rates, yet leave participants with the freedom to choose other distribution methods.

III. Expanding Coverage for Low and Moderate Earners

In 1999, only 50 percent of private sector workers aged 25–64 participated in an employer-sponsored pension. The coverage rate has remained virtually unchanged since 1979, even though 1979 was the end of a decade of stagnation and 1999 was the height of the longest expansion in the post-war period. Participation in a pension plan is closely correlated with earnings levels. In the top quintile of the earnings distribution, about 70 percent of workers—both male and female—participate in pensions; in the bottom quintile, that figure drops to about 20 percent for men and 10 percent for women.

The lack of pension income for low-wage workers would not be a source of concern if Social Security provided enough income for them to maintain their pre-retirement standard of living. Most observers, however, conclude that Social Security alone is inadequate when viewed either in terms of replacement rates or in relation to poverty thresholds. The question is how to provide additional pension protection to low-income workers.

After nearly 60 years, it is obvious that the current system is not structured to provide much to the bottom 40 percent and is unlikely to do a significantly better job in the future. Moreover, it is unclear whether an expansion of the employer-based system is desirable. Some advocates for extended pension coverage argue as if private pensions were a way for employers to give something to their employees. Economists typically maintain, however, that the introduction of a pension implies a reduction in cash compensation. It does not make sense to increase the pensions—and thereby reduce the wages—of these low-earning workers. The only reasonable way to improve retirement benefits for low-income households such as these is to increase their lifetime income through some redistributive device, not through the extension of employer-provided pension plans.

People at the low end of the wage distribution ($20,000 or under, indexed for wage growth) should receive their retirement income directly from the government and should be excludable from the employer-sponsored pension system (Munnell and Halperin 2002). This program could be financed by general revenues, but it also seems reasonable to place more of the burden on those now enjoying tax-subsidized savings. The specifics of the proposal are less important at this point than recognizing that a significant portion of the population is never going to gain coverage under the existing employer-based system.

IV. Conclusion

Let me conclude. The collapse of Enron and the loss of employee 401(k) money have brought the issue of diversification and employer stock to the fore. Given that 401(k)s are tax-subsidized plans to ensure a secure retirement, they should be limited to prudent investments. Allowing employees to put all their eggs in one basket is not prudent, and Congress should enact mandatory diversification provisions to avoid such concentration. Also, existing provisions that prevent employees from selling employer stock make it difficult for employees to diversify their portfolios, and they should be repealed.

But I would urge this Committee to go beyond the issue of employer stock. 401(k) plans have exploded in the last 20 years and are due for a thorough review. These plans have many strengths, but their voluntary nature often produces less than optimal results. Leaving 401(k) participation and contribution decisions to employees has created a situation where roughly one quarter do not join the plan, and only 5 percent contribute the maximum. Lump-sum payments mean that individuals face outliving their resources or depriving themselves in retirement. The solution to all these problems appears to be taking advantage of individual inertia and setting the defaults to the desired outcome. That is, force individuals to opt out rather than into plans, set high default contribution rates, and make annuities the default form of payout. Such changes would produce the best outcome for most people, and leave others free to choose an alternative option.

Finally, pension solutions for low-income workers may have to be found outside the traditional employer-sponsored pension system. The existing system has been in place for a long time and has made little progress in coverage for low and moderate earners. I do not see any reason to think that the situation will improve in the future. Moreover, low earners can ill afford to sacrifice current earnings in exchange for future pension benefits. My view is that the best way to increase the retirement income for this group is through a government-sponsored program that increases their lifetime income.

Thank you so much for the opportunity to appear today, and I would be delighted to answer any questions you might have.

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Mr. SALISBURY. Mr. Chairman, members of the committee, thank you. It is a pleasure to be here.

Since my full statement will be in the record, I will dispense with the reading of my testimony and simply offer a few brief comments on some of what has been raised today.

First, I wish to underline, particularly based on the tragic stories that we have heard today, that this is not a 401(k) crisis, and this is not a retirement crisis. This is a crisis related to corporate wrongdoing, fraud, and criminal charges.

In fact, 338,000 401(k) plans do not include company stock and are quite secure today. Two thousand 401(k) plans do include company stock, and in addition, there are about 8,000 employee stock ownership plans.

Second, where employer stock is present, few workers actually concentrate their assets. Mr. Corzine mentioned the number of 43 percent employer stock in firms with more than 5,000 employees; that number is actually 26 percent. Fifty-three percent of participants actually have less than 20 percent of their money in company stock; 73 percent less than 50 percent; only 27.5 percent have more than 50 percent of their assets in company stock out of those 2,000 plans.

The chart that was shown is accurate data, but it is exceptional in that it points out the small number of companies that also generally provide a defined benefit pension plan plus Social Security, plus very frequently, retiree medical benefits and pay wages that

are well above market averages, and this is in fact part of diversification, if you will, in a broad sense.

Third, as we have heard the tragic stories and outcomes today, we must not lose sight of a balance issue. There are literally millions of Americans retired today exclusively because they did not diversify—individuals who retired with millions over time from Proctor and Gamble, from IBM, and numerous other companies. This does not argue against diversification. It is simply to underline that there are balance issues here. If this is a 401(k) crisis, the question is: Would not many of the companies on that chart today have already experienced massive movement by their employees out of the stock of that company?

And as with Enron, as reported by the Congressional Research Service, 11 percent of the corporate stock was there by demand of the company; 89 percent was there by the free choice of the individual participant. I do not say that as a criticism of the participants' decisionmaking, but this in essence goes to the core of the issue that this is more about employee choice and regulation of employee choice than other issues.

Fourth, the type of diversification that Ms. Munnell mentioned is present in other plans, was present in the Enron plan, and is very common.

Fifth, on the question of Senator Kennedy regarding individual brokerage windows and could the Enron employees purchase any stock they wished, the answer, Senator, is yes. They had an open window, as do the participants in my 401(k) plan, as do the participants in a large number of the 401(k) plans on that chart, and those individuals could in fact choose to buy 100 percent of somebody else's company, so to speak, through the existing plan.

Finally, if one looks at the general issue of what has been delivered through the overall system, I would simply emphasize that the growing trend toward employee choice in this program has largely been demanded and frequently demanded by employees themselves. One company in Boston, for example, Raytheon, had a restriction on the amount of stock that an employee could hold, and underdemand of the workers eliminated that restriction, and they moved to a free choice mode.

Implementation of a dollar limit or a percentage limit administratively, I would add, would be far more difficult to deal with than simply deciding you cannot have company stock. The worst possible situation I can imagine is somebody who has 19 or 21 percent in company stock, the stock just starts to automatically go through the roof because of some technological advance or otherwise, and the law has said they have to be liquidated by the computer automatically. I do not think that would make the individual happy; he or she would be better off, frankly, not to have had the opportunity in the first place.

Finally and in conclusion, I would note that on the lockdown issue and the administrative issue, while I hate to suggest that technology has not become totally magical, the statement of earlier members of the panel that technology would allow money to be transferred very quickly is absolutely correct. It can be done in a flash. The reason for lockdowns or blackouts is not because of the difficulty of transferring money; it is the transfer of millions or tens

of thousands of individual account records. With the money transfer, the problem is the inability to make the other adjustments; that does in fact take more time than the flash of electronic recordkeeping.

Thank you.

[The prepared statement of Mr. Salisbury follows:]

PREPARED STATEMENT OF DALLAS L. SALISBURY

Mr. Chairmen and Members of the Committee: I am Dallas Salisbury, president and CEO of the Employee Benefit Research Institute (EBRI), a nonprofit research and education organization founded in Washington, DC in 1978. EBRI does not lobby or advocate for or against legislative proposals. Our work is intended to assist in evaluating present policies and the possible results of proposals made by others.

I was pleased to accept the invitation of the Committee to join this important hearing on retirement security. My first testimony before this Committee was in 1981, on the same topic. At that time, the issue was the solvency of the Pension Benefit Guaranty Corporation and the future of defined benefit pension plans. Because that program is solvent, retirees and vested employees of Enron should know that they will be paid benefits due from the Enron Defined Benefit Pension Plan, up to the maximum guaranteed amount of $3,392.05 per month ($40,704.60 per year) (see www.pbgc.gov for details of phase-ins, reductions for early retirement, and other adjustments), should the plan ultimately have to be terminated and taken over by the PBGC. This will not fully protect the pensions of highly paid workers, but the rank and file will be secure.

Defined benefit plans, as other witnesses have noted, are primarily sponsored by employers that are large, with higher paid or unionized work forces. I would add that they are confident of profitability. The total number of participants protected by the PBGC has increased about 30 percent since the program was established in 1975, while the labor force has grown more quickly. My elderly parents in Everett, WA, are better off than they would otherwise be due to the defined benefit pension checks that resulted from my father spending 30 years with an employer that had a defined benefit plan.

My 1981 testimony noted that our tax laws began to encourage the development of defined contribution plans in the 1920s. The primary emphasis then was on profit-sharing plans that allow flexibility of contributions based upon the economic performance of the employer, and flexibility for the employee in deciding whether to fully defer contributions. The primary growth of defined benefit plans took place during the Korean War wage price controls when the government ruled that increased pension contributions would not count as wage increases. Large private employers have historically had both defined benefit and defined contribution plans, while small employers have historically had only defined contribution plans. EBRI small employer retirement surveys have documented the reasons for this preference, and the reasons that most small employers provide no retirement savings plan. Most prominent are the employees' desire for cash and the lack of profitability of the enterprise. EBRI Value of Benefits surveys and our Retirement Confidence Surveys have documented that workers have a strong preference for defined contribution plans, as they build an account with contributions that are proportional to pay, they are easy to understand, they are fully portable when the worker changes jobs, and they provide a feeling of control. The Federal Government reduced the value of its own defined benefit plan by 40 percent and established the Thrift Savings Plan (TSP) in the early 1980s, for many similar reasons: employee appreciation, greater value delivered to shorter service employees, predictable cost for the employer, and neutrality relative to employee mobility as compared with the "golden handcuffs" of defined benefit pension plans. Participation in defined contribution plans has grown by more than 300 percent since the passage of ERISA.

Growth of the 401(k) plan was celebrated by many over the past several years as account balances grew and the plans created new individual wealth. It has been questioned by others. The numbers indicate that the growth of 401(k) plans has led to more financial education in the workplace, with more employers facilitating access to investment advice as well. My in-laws in West Hampstead, NH are better off that they would otherwise be today due to the defined contribution plan that my mobile father-in-law had during his last decade of employment.

EBRI provides an interesting example of plan formation decision-making. EBRI was founded in 1978 by 13 actuarial consulting firms. This group was joined by group insurance companies, investment management firms, labor unions, multi-em-

ployer pension, health and welfare plans, and business corporations that sponsored pension, health, and welfare plans for their employees. The common element: a belief in the provision of economic security benefits to workers and the value of sponsoring research and data collection to facilitate understanding the programs. These firms were *all* strong supporters of defined benefit plans, yet they would not establish a defined benefit plan for the employees of EBRI. Instead, they established an employer funded defined contribution (money purchase) plan in 1979 to which EBRI contributes 8 percent of pay for each employee and a 401(k) plan in 1983 in which EBRI will watch the first 4 percent of contribution at a 100 percent rate. They had a number of reasons for doing defined contribution: (1) the annual cost could be budgeted and did not change with the economy; (2) EBRI might or not be around for the decades necessary to provide meaningful benefits from a defined benefit plan; (3) EBRI might or might not end up with long-service employees who would benefit from a defined benefit plan; (4) the 401(k) plan allowed EBRI employees to save added dollars if they wanted to do so; and (5) the matching contribution could provide an incentive for employees to do so. The decision was made to go with defined contribution for these reasons, even though (1) a defined benefit plan would have been less costly to operate; (2) less costly over time in terms of contributions; and (3) could have included lump-sum distributions so that departing employees did not have to be tracked after leaving. These issues are common to many small- and medium-size employers. As in so many aspects of life, one "size" does not fit all. At the point ERISA was enacted in 1974, for example, there were approximately 200,000 defined contribution plans and 100,000 defined benefit plans, underlining differences in employer decision making. Today there are approximately 800,000 defined contribution plans and 60,000 defined benefit plans.

401(k) Prevalence

Studies based upon the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project for the past five years document points that are central to retirement security. This database is representative of the universe of 401(k) plans. The U.S. Department of Labor, and others, provide data updates on the full plan universe:

• There are an estimated 43 million participants in an estimated 340,000 401(k) plans, with an estimated total of about $1.7 trillion in assets. Actual universe counts lag by several years, making estimates necessary. 401(k) plans have a wide range of designs, but most differ from that of the Enron 401(k) plan as most do not include company stock.

401(k) accounts grew dramatically from 1983 until 1999. With the decline in the equity markets in 2000, the average account balance of workers in plans in both 1999 and 2000 declined by an average of one-tenth of one percent, largely as a result of new contributions being made and diversification of plan assets through the selection of professionally managed funds provided by financial institutions. We are now beginning to review data from 2001, but expect a small average decline for a second year. EBRI's November 2001 *Issue Brief* provides detail on investment allocation, account balances, and multiple other issues (see www.ebri.org.)

Company Stock

The incidence of company stock in 401(k) plans has been analyzed extensively as part of the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project for the past five years. A special report published by EBRI last week looks at the company stock issue. The most recent information published in November 2001 applies to year-end 2000 account balances and shows that:

• The aggregate percentage of 401(k) assets that are in company stock is equal to 19 percent and has stayed constant over the last five years.

• Where company stock is offered as either an employer match and/or an employee investment option, 32 percent of plan assets are in company stock if the plan sponsor does not offer a GIC (guaranteed investment contract, a stable-value investment) and 28 percent if it does.

• Where employer matching contributions are provided in the form of company stock, 33 percent of employee-directed deferrals are in company stock. But where company stock is not the match (but is available as an investment), 22 percent of employee deferrals are in company stock. These numbers suggest that employees view company stock as a desirable option.

Although the topic of company stock investment in 401(k) plans has recently been the focus of considerable interest, the concept of preferred status for employee ownership has been part of the U.S. tax code for more than 80 years. When the Employee Retirement Income Security Act (ERISA) was passed in 1974, it required that fiduciaries diversify plan investments for defined benefit plans and some types of defined contribution plans. However, there is an exception for "eligible individual ac-

count plans" that invest in "qualifying employer securities." An Employer Stock Ownership Plan (ESOP) normally qualifies for this exception, as do profitsharing plans.

Congress has acted repeatedly over the last 40 years to provide incentives for employee ownership. Former Senator Russell Long (D–Louisiana) was the primary champion of the provisions, believing that employee ownership was a form of worker democracy and "gainsharing" as employers grew and prospered. Employee ownership has also been shown to align employee, management and shareholder objectives, resulting in greater productivity and growth. Employers like Procter & Gamble have relied upon profit sharing and employee ownership as the retirement program for decades, and new economy firms like Microsoft and Sun Microsystems have done the same. Employers match employee contributions in 401(k) plans as a means of encouraging participation, and some employers match in company stock to meet an employee ownership objective. Provisions enacted as recently as 2001 in EGTRRA related to the deduction of dividends paid to shares held in an ESOP have served to communicate to employees and employers that government policy seeks to encourage employee stock ownership.

EBRI's recent *Special Report* on company stock (see www.ebri.org) notes that profitsharing plans with cash or deferred arrangements (more commonly referred to as 401(k) plans) grew from virtually no plans in 1983 to a point where by 1997 (the most recent year for which government data are currently available) they accounted for 37 percent of qualified private retirement plans, 48 percent of active employees, and 65 percent of new contributions.

Enron had a defined benefit pension plan, matched employee contributions with company stock, and restricted diversification until after the age of 50. At Enron, 57.73 percent of 401(k) plan assets were invested in company stock, which fell in value by 98.8 percent during 2001.

To produce the Special Report on company stock, initiated as a result of a high number of inquiries following the collapse of Enron, on Jan. 15, 2002, a fax-back survey was sent to 3,346 members of the International Society of Certified Employee Benefit Specialists (ISCEBS). Respondents were asked to respond by Jan. 23 and to answer the questions for the largest (in terms of participants) client they worked for (if they were a consultant or service provider for 401(k) plans); otherwise, they were asked to answer for the firm that they were employed by. The survey was designed, fielded, and analyzed by Professor Jack VanDerhei of Temple University, who also serves as research director of the EBRI Fellows Program. The full report is an appendix to this testimony.

VanDerhei notes in the report: "Presumably, any recommendations to modify current pension law would attempt to strike a balance between protecting employees and not deterring employers from offering employer matches to 401(k) plans. Some have argued that if Congress were to regulate 401(k) plans too heavily, plan sponsors might choose to decrease employer contributions or not offer them at all. Previous research has shown that the availability and level of a company match is a primary impetus for at least some employees to make contributions to their 401(k) account. Others have argued that individuals should have the right to invest their money as they see fit.

"This survey was conducted in an attempt to provide a context to the current debate on company stock in a timely fashion, and it is not a statistically representative survey of the 401(k) industry; rather, this survey is a nonrandom polling of benefits professionals who are knowledgeable about the subject matter and able to respond to the survey quickly."

Company Stock: Availability and Percentage of Average Asset Allocation

• 48 percent of the respondents to this survey reported a company stock investment option in their client/employer's 401(k) plan.

• Large plans (defined as those with 5,000 or more employees) are much more likely to have a company stock option in the 401(k) plan: the large plans had this option 73 percent of the time vs. 32 percent for small plans (defined as those with fewer than 5,000 employees).

• Among those plans that have a company stock option, the average percentage of company stock in the employees' 401(k) account breaks down as follows: Less than 10 percent (39 percent); 10–50 percent (42 percent); more than 50 percent (18 percent).

• Large plans have a higher average percentage of company stock in the employees' 401(k) account

Employer Contributions: Investment in Company Stock and Restrictions on Sale

- 43 percent of those having a company stock investment option in the 401(k) plan reported that employer contributions were required to be invested in company stock.
- Among those plans that have a company stock option, large plans are more likely to require employer contributions to be invested in company stock: 49 percent of large plans vs. 38 percent of small plans.
- Of the 401(k) plans where employer contributions were required to be invested in company stock:
  - 13 percent reported no restrictions existed for selling the company stock.
  - 27 percent reported that they were restricted throughout a participant's investment in the plan.
  - 60 percent reported that they were restricted until a specified age and/or service requirement is met.

Limitations on Company Stock That May Be Held by an Employee

- 14 percent of those having a company stock investment option in the 401(k) plan reported that they limited the amount or percentage of company stock that employees may hold in their 401(k) plan.

Blackouts

- 74 percent of the respondents' plans have undergone a blackout.
- Of those that have undergone a blackout, the distribution of the blackout period follows:
  - No delay/overnight/over weekend, 3 percent.
  - Between one day and two weeks, 27 percent.
  - Between two weeks and one month, 39 percent.
  - Between one month and two months, 26 percent.
  - More than two months, 5 percent.

Impact of Defined Benefit Sponsorship

- It is more likely for there to be a company stock investment option in the 401(k) plan if there is also a defined benefit plan: 60 percent of those with a defined benefit plan vs. 35 percent of those without.
- Employer contributions are more likely to be required to be invested in company stock if there is also a defined benefit plan: 50 percent of those with a defined benefit plan vs. 33 percent of those without.
- It is more likely for restrictions to exist on selling the company stock if there is also a defined benefit plan.

Respondents' Perceptions on Appropriate Limits and the Role of Government

- When asked what they thought was the maximum percentage of company stock any employee SHOULD hold in his or her 401(k) portfolio, the distribution of responses was.
  - 4 percent of the respondents thought it should be zero.
  - 39 percent replied with no more than 10 percent.
  - 38 percent replied with no more than 20 percent.
  - 9 percent replied with no more than 50 percent.
  - 9 percent did not know.
- When respondents whose client/employer did not require employer contributions to be invested in company stock were asked if they thought the government should limit the plan sponsor's ability to mandate that matching contributions to a 401(k) plan be invested in company stock, 66 percent of the respondents said yes, 29 percent said no, and 5 percent did not know. However, when respondents whose client/employer did require employer contributions to be invested in company stock were asked if they thought the government should limit the plan sponsor's ability to mandate that matching contributions to a 401(k) plan be invested in company stock, 38 percent of the respondents said yes, 61 percent said no, and 2 percent did not know.
- When asked if they thought the government should limit the employees' ability to invest their own (participant-directed) contributions to a 401(k) plan in company stock, 32 percent said yes, 63 percent said no, and 5 percent did not know.

Respondents' Perceptions on Public Policy Issues Related to Company Stock in 401(k) Plans

- Respondents were fairly evenly split on whether they thought there was an inherent conflict of interest when a plan sponsor includes company stock as an option in their 401(k) plan.

• The vast majority of respondents (83 percent) strongly agreed that plan sponsors that offer company stock as an investment option should advise their employees to diversify.

• Respondents were fairly evenly split on whether they thought ERISA should be revised to require pension plan diversification or participant direction if an employee is over-invested in company stock.

• The majority of respondents (58 percent) agreed that problems resulting from employees investing their own contributions in company stock would be mitigated if employers were allowed to provide independent financial advice to their employees. Only 27 percent of the respondents disagreed with this statement.

• The majority of respondents (56 percent) did not agree that 401(k) plan sponsors should be allowed to mandate that matching contributions be invested in company stock, while 39 percent agreed, and 5 percent were neutral.

• More than 3 in 5 respondents (62 percent) did not agree that 401(k) plan sponsors should be allowed to restrict the sale of company stock they contributed on behalf of the participants as long as they are employees. 29 percent of the respondents agreed and 9 percent were neutral.

Respondents' Perception of the Impact of Various Legal/Legislative Developments

• Nearly one-half (47 percent) of respondents thought the most likely reaction to a successful class action suit alleging fiduciaries failed in their obligation to cease using company stock as the form of the matching contribution prior to the firm's bankruptcy would be to discontinue the use of company stock as the form of matching contribution or as an investment option.

• More than one-half (52 percent) of the respondents thought that the most likely reaction to a successful class action suit alleging fiduciaries "pushed" the company stock on employees through the 401(k) plan would be to discontinue the use of company stock as the form of matching contribution or as an investment option.

• Nearly 7 in 10 respondents (69 percent) thought that the most likely reaction to a legislative change reducing the deduction for matching contributions in the form of employer securities to 50 percent would be either to discontinue the use of company stock as the form of matching contribution or as an investment option, or to decrease the matching contributions.

• Approximately one-third of the respondents (37 percent) thought that the most likely reaction to a legislative change requiring immediate transfer availability for company stock for employees after 90 days would be either to discontinue the use of company stock as the form of matching contribution or as an investment option, or to decrease the matching contributions. However, another 35 percent thought that there would be no reaction.

• Nearly one-half (47 percent) of respondents thought there would be no reaction to a legislative change limiting to 20 percent the investment an employee can have in any one stock in his or her individual account plan. Another 28 percent thought that this would cause plan sponsors either to discontinue the use of company stock as the form of matching contribution or as an investment option, or decrease the matching contributions.

Employee Education

ERISA and its implementing regulations seek to assure extensive employee education. Sec. 404(c) of ERISA sets forth the types of conditions a plan sponsor must meet in order to allow a participant to exercise control over his or her participant-directed individual account. Providing sufficient information to make an informed investment decision is one of the requirements. The regulations do not set forth either "bright line" tests or offer a "safe harbor," but many employers have sought to meet what they believe to be required in an effort in the hope that it will reduce their fiduciary exposure. Interpretive Bulletin 96–1 provided additional guidance intended to increase the amount of participant investment education delivered to participants. A recent opinion letter issued to SunAmerica, like a number of previous actions of the Department of Labor, was aimed at increasing the provision of investment advice to plan participants, in addition to education. Technology has facilitated the delivery of both education and advice to plan sponsors and participants that desire it. Legal provisions provide special exceptions for employee stock ownership in defined contribution plans from normal rules related to diversification and employee direction.

Congress enacted the SAVER Act in 1997 to encourage savings and investment education. The first SAVER Summit was held in 1998, and the second will be held the end of this month. Inspired by the passage of SAVER, EBRI worked with partners to form the Choose to Save® public service announcement program in 1997. Those public service announcements, plus four Choose to Save® specials, have now

taken messages of savings, compound interest, debt management, diversification, and more, to viewers in 49 states (see www.choosetosave.org). The National Association of Broadcasters, AP News Radio, ABC, CBS, Bonneville Radio, and others have worked together to expand the program in each of the last five years (Fidelity Investments has underwritten production and distribution of the program).

The Retirement Confidence Survey has been used to assess the level of financial education and preparation, attitudes toward retirement and savings, and what education approaches are valued and used by workers. Over the 11 years of the survey, we have seen steady movement toward more saving and retirement preparation, but the survey clearly documents that there is much more to be done.

While the surveys find that the public places very high-value on Social Security and Medicare, it also underlines the public's desire for control of their own savings and investing.

Conclusion

Since the Bureau of Labor Statistics began a data series on job tenure in 1952, median job tenure for the total labor force has remained near four years. In spite of this short median tenure, about a quarter of all workers ages 55-64 report having spent 20 or more years with one employer, but that means 75 percent have not. For long-service workers defined benefit pension plans can provide meaningful benefits. For short-service workers defined contribution plans will do a better job of accumulating retirement income if the worker chooses to participate and contributes over many years. For both types of plans an essential element is saving the money upon any job change, obtaining good investment results, and spending the funds at a rate that keeps them from running out. Most defined contribution plans, including the federal Thrift Savings Plan (TSP), provide the option of lump-sum distributions. A growing number of defined benefit plans provide a lump-sum option as well upon job change, including the Federal employee defined benefit plan. Those with both types of plans have the opportunity for the best of both, but also face the risks and responsibilities of both. As noted above, when both types of plans are offered in the private sector, there is a greater likelihood of company stock being used in the 401(k).

The relevance of Enron for 401(k) participants in the estimated 338,000 plans without company stock matches, is that it sends a message about the value of diversification. For participants in the estimated 2,000 plans that match with company stock, it is a more powerful message of diversification for the funds contributed by the employee and for assets outside the 401(k) plan. Diversification is a function of all assets and income sources. The presence of Social Security allows investors covered by this program (nearly 99 percent of the labor force) to take higher risks in their investments. The presence of a defined benefit plan allows a participant to take higher risks in their 401(k) plan. The Internet allows access to financial tools for education and advice undreamed of 20 years ago. Growing life expectancy and longer retirements make it increasingly essential that our citizens be financially literate, that they understand investing, and that they understand how quickly they can spend funds in order to not outlive them. The public and private sectors are working together to increase financial literacy, to distribute those tools, and to increase their use. A silver lining of Enron is the attention being given to education, advice, diversification, financial literacy, and other financial education issues. There is a great deal to be done, but programs like Choose to Save® can make a difference. A negative is the suggestion that Enron means that the entire 401(k) system is in "crisis," because that is not true. As we deal with Enron, we must take care not to inappropriately undermine confidence in 401 (k), IRA, and other programs, which are sound for the vast majority of participants.

Thank you for the invitation to testify today on this important topic. I would be pleased to take questions now, and to respond to written questions following the hearing.

The CHAIRMAN. Thank you very much.

Mr. Prentice, as the chairman of the Administrative Committee, you and the other members of the committee are the fiduciaries under ERISA, and you are all required to discharge your duties with respect to the plan solely in the interest of the participants and beneficiaries.

Disturbingly, the Enron executives sold over $1 billion in stock while Enron workers lost over $1 billion of their retirement. On Tuesday, your colleague on the Administrative Committee, Cindy

Olson, testified that about a year ago, she sold $3 million of Enron stock when it was near its peak. Did you also sell stock in the last year?

Mr. PRENTICE. Yes, I did.

The CHAIRMAN. For how much?

Mr. PRENTICE. I exercised some stock options in June of last year, and exercised a same-day sale, and it was about $900,000. I also sold approximately 50,000 shares of Enron stock that I had in my own account on November 28 for about $1 a share.

The CHAIRMAN. But in the earlier sale, you made how much?

Mr. PRENTICE. Nine hundred thousand.

The CHAIRMAN. Nine hundred thousand. How can Enron executives sell and yet continue to allow workers to risk their retirement savings?

Mr. PRENTICE. I am not sure that the two are connected. Speaking as a member of the Administrative Committee, as I stated, I felt that it was our responsibility—and I do accept that we have a fiduciary responsibility—to oversee the savings plan and to provide as many options as we can for the diversification efforts of those employees. That is not the only retirement plan within Enron. There is another pension plan, and the 401(k) savings plan is in addition to those pension funds.

The CHAIRMAN. But the great majority of stock obviously was in Enron.

Mr. PRENTICE. Not in the pension fund; in the 401(k), at the beginning of the year, I think it was 60, 61 percent, and at the end of the year, it was 20 percent or so.

The CHAIRMAN. Do you feel that you have violated your fiduciary duty?

Mr. PRENTICE. I definitely do not, sir.

The CHAIRMAN. Professor Munnell, would the President's proposal fix the problem of lack of retirement security in the 401(k)?

Ms. MUNNELL. No, it will not. There are some good proposals in there, but the key thing that needs to be addressed is diversification, and it has to be mandatory diversification. We have to have limits on how much employees can invest in employer stock in 401(k) plans.

The CHAIRMAN. You listened all morning very patiently to these arguments about balancing freedom and security. How do you answer that?

Ms. MUNNELL. Allowing people to invest a lot of money in their employer stock is imprudent. These 401(k) plans are tax-subsidized plans; they are designed for retirement. We want people to end up having money when they stop working. We want to make sure that their investments are solid, and the only way you can guarantee solid investments is to not put all your eggs in one basket. You have to have mandatory diversification.

The CHAIRMAN. I want to thank our employees very much for their presence here today. As Senator Wellstone pointed out, these are extraordinarily sad and difficult times for people who have really devoted their lives to companies. The greatest violation is the violation of trust which has been referenced by each of you in terms of your devotion to those companies and your commitment to, I am sure, produce, work hard, give it the best day in and day

out, relying on the trust of those companies, and then, in the circumstances to find out that that has been violated. That is heavy enough, plus the extraordinary loss to your own security at this time of your lives, after you have worked hard and played by the rules, is just an extraordinary burden.

I commend all of you for your willingness to come and share your stories with us at this difficult time. The best way we can thank you is to try to do the best we can to help you and to make sure it does not happen to others.

Paul?

Senator WELLSTONE. Thank you, Mr. Chairman.

Let me start with Ms. Fleetham. Just to be clear, you issued a sell order that usually would take place in 7 to 10 days, and instead, it took somewhere between 20 and 30 days; is that correct?

Ms. FLEETHAM. Yes.

Senator WELLSTONE. It is not totally clear to me when the actual sale took place, but it was certainly longer than 7 to 10 days; right?

Ms. FLEETHAM. Yes.

Senator WELLSTONE. And this was when the stock was plummeting in value, too, during this period of time?

Ms. FLEETHAM. Obviously.

Senator WELLSTONE. Did you ever get an explanation to the company as to what happened or as to why this happened?

Ms. FLEETHAM. No. Basically, what I got was the statement that I had gotten—first, the confirmation of the order with the dates on it, and then, the actual distribution statement with those dates on it. And obviously, I knew what had happened when I saw that it had not actually been done until the 30th of October. Why it had been done then, I do not know, and why it was done during a supposed lockdown period, I do not know.

Senator WELLSTONE. Had this ever happened to you before?

Ms. FLEETHAM. No. Generally speaking, when we first started this, there was a point in time where, if I remember correctly, you did have to have your sell request in before the 20th of the month, and then your stock would be sold the next month. Then, the last few years, there was an option where you could check a box that said you wanted to waive the 30-day waiting period and sell the stock as soon as practicable. And apparently, that must have been "practicable"—and that is the word they use—on the part of whomever was selling it. It certainly was not on the sellee. And I do not know why—previously, I had put in some orders, and by checking this box had probably had a check back in as early as 10 days; sometimes it was a couple weeks, but I would say 7 days to 2 weeks.

Senator WELLSTONE. I am guessing that you might favor a rule that would shorten the time for lockdown periods.

Ms. FLEETHAM. Well, yes and no. I am not sure now, if they can sell it whenever they want to anyway.

Senator WELLSTONE. That is something that we really ought to come to understand, that is for sure.

I want to thank all of you, but let me go on with a few more questions, and I am not going to do justice to the appearance of each one of you, and maybe I should even say it now—I do want you to know, however, that all of your statements will be made a

part of the record, and all of it is going to be used—I do not think this can be symbolic. If we did not pass legislation here that really made a difference in terms of making sure this did not happen to people again, none of us deserves to be here. So I do not think this is just symbolic, and I want you all to know, even if I do not put questions to you, that what you have said today has been so powerful, so powerful.

Mr. Prentice, would you agree, just to go through this quickly, that diversification is the foundation of prudent investing?

Mr. PRENTICE. It is one of the foundations, yes.

Senator WELLSTONE. And would you agree as well that no financial planner would advise an investor to have, let us say, more than 10 percent of his portfolio invested in one single security?

Mr. PRENTICE. I cannot specifically speak to a number, but I agree with the concept of spreading the risk.

Senator WELLSTONE. As a rule-of-thumb.

Mr. PRENTICE. Yes.

Senator WELLSTONE. What steps did you take—and by the way, I appreciate your being here, and I appreciate your testimony, and I want to be clear about that; others have sidestepped even being here, and you did not—what steps did you take to educate people about the need to not have so much or such a large percentage of their retirement savings tied up in one stock, the stock of their employer—and of course, this was the source of their income to boot. Did you take some steps to educate people about the danger of this?

Mr. PRENTICE. As the Administrative Committee specifically knows, we oversaw or we were in serious discussions with the Enron Benefits Department, and then they, through the various human resource departments—I am aware of multiple attempts over the years to distribute various brochures; they have distributed CDs. The primary purpose of the information was first of all to encourage participants to participate in the 401(k) plan, and in just about every document that I can remember, at some point in time, it would mention that diversification is very important. Each one of the options—and we had 20 different individual options, one of which was Enron stock—that in and of itself, I believe, shows that we encouraged people to diversify into other investment options, and in each one of those options, there were short writeups describing those options and mentioning the various risks associated with them.

Senator WELLSTONE. Would you be willing to provide me with some of those documents where Enron mentioned the word "diversification"?

Mr. PRENTICE. Yes, I would.

Senator WELLSTONE. I ask you because—and I held this up earlier; it is entitled, "Money in Motion: Enron Corporation Savings Plan and 401(k) Plan Details," which I know you are familiar with—this is what the company gave to the employees to describe the plan, and I have looked through the whole document, and I do not find the word "diversification" anywhere in this document.

Mr. PRENTICE. Senator, the one that I reviewed recently was the compact disk. It was a fairly sophisticated brochure, and I remember specifically reading—I think it was quoting John Vogel, who is

a well-known investment advisor—it was quoted in there that the key thing in a program is diversification, diversification, diversification.

Senator WELLSTONE. I would like to see that.

Did you hold meetings with employees where you also mentioned the importance of diversification? Were there any of those kinds of educational efforts?

Mr. PRENTICE. Again, not me personally, but the Benefits Department and the Human Resource Department I believe did that, yes.

Senator WELLSTONE. Now that Enron is in bankruptcy, does Enron stock remain a prudent investment plan in the 401(k) plan?

Mr. PRENTICE. We at the Administrative Committee have taken this under consideration, and to help us decide whether it is a prudent investment, we have hired an independent investment counselor/advisor to assist us in making that decision.

Senator WELLSTONE. I have here: "Until the bitter end, Enron executives continued to tout Enron stock to workers in a series of emails. On August 14, Enron CEO Kenneth Lay told workers that he' never felt better about the prospects for the company.' On August 27, Lay predicted to workers a' significantly higher stock price.' And on September 26, Lay called Enron stock' an incredible bargain.' Even as they promised the moon, Lay and other executives were cashing in their stock."

So the question I am asking is when does it become imprudent.

Mr. PRENTICE. Senator, I share the concerns of the stock price. I am not a professional investment advisor. I think that as a prudent person on the Administrative Committee, we have taken steps to get that professional advice, and we are awaiting that initial report from that investment advisor.

Senator WELLSTONE. Professor Munnell, I want to ask you—and I am not asking you for a yes or a no on this—and again, I want to tell all of you that when I met with Jan, she knows 100 times more than I do; I am far from an expert on all of this, and I am just trying to learn—but you were saying that you think there has got to be some kind of threshold here, 20 percent or something. I have been doing some thinking about this and thinking that maybe it would not just include the 401(k), but you could include the defined benefits package, which would give employers an incentive for that in figuring that 20 percent, if you see what I am saying. There is more flexibility.

Would you be willing—I am not asking for a yes or no—but would you be willing to give my office some advice on this as we try to figure out what would be best?

Ms. MUNNELL. I would be happy to work with you. I worry about all of these proposals that involve a percentage, because it means that as soon as you go over the percentage, you have to do something. So I think I would start——

Senator WELLSTONE. OK. Let me hear that—and I see some others nodding—let me hear from all three of you on that. Let us go on a little while here—not too much longer—but go ahead.

Ms. MUNNELL. I think the way to limit it is probably just to tell employees within the 401(k) that they do not have company stock as an option—just eliminate it. And then, if the employer wants to

do the match with employer stock, so be it. But that would have solved a lot of the problems at Enron, because most of the money in the fund came from employee contributions, not from the employers. And employees are put under such pressure to show that they are team players, that they are really for the company, so it is natural that they want to invest where they work, and it is just such an imprudent thing to do.

Senator WELLSTONE. I was a teacher, and I am pretty good at reading faces. There are at least three of you who want to jump in here. Mr. Farmer does, and Jan, I could not tell whether you were shaking your head this way or that way; and I want to hear from Mr. Salisbury as well.

Mr. FARMER. Early on in Polaroid Corporation, Dr. Land was vehemently against the employees purchasing stock in the fashion that the company would provide for them. There were no stock option plans for the people in the company, and the reason was just that—he did not want to make it something that somebody would—I mean, you could go out naturally on your own and purchase stock, but doing it through the corporation sent a message from the corporation and put the corporation at risk for giving you a message of the wrong kind, especially in the stock of Polaroid, which was in essence a luxury stock, because it was volatile and went up and down. So for that reason, he did not provide stock options for the employees.

Senator WELLSTONE. Mr. Salisbury?

Mr. SALISBURY. Senator, my concern about set limits if it is in an employee choice plan, whatever you pick as a percentage, is the difficulties in administration of it plus the potential of when they run up against that limit, just the necessity of automatic liquidation, which essentially, the greatest likelihood of automatic liquidation would be at the time that the stock is going up the most, which is the reason I say that if you are going to choose to make people diversify, you are almost better off to just not have employer stock as an option at all in the employee account per what Alicia is mentioning—it is a proposal that I know was in AARP testimony a few days ago—as opposed to trying to come up with some set percentage limit. So my only administrative suggestion to you would be that it is almost better to do an all-or-none than to try to make some percentage amount work as a practical administrative matter.

The second comment goes to the Polaroid example, and I have two brief comments. One is the basis of employee stock ownership and the primary advocacy for it came from Senator Russell Long of Louisiana during all the years that he was the Democratic chair of the Finance Committee, as a very populist motion. During the years of that advocacy by Russell Long, he was actually frequently criticized by many on the right for being an advocate of essential communism and social democracy that was undesirable and unacceptable. It is always interesting to see how, over time, these debates change.

The second is the dilemma that I am sure the individual at the far end of the table might be able to comment on, or might not want to but might be able to. That is, in many, many, many corporations that I deal with, the people in the finance function and

the benefits function would look at you and say, "It would be best if we did not have employer stock in this plan." And it is the CEO and the most senior officers who are committed to the concept of employer stock. And against this issue of cutback, the discussion that always takes place is if you could not have employer stock, what would the CEO do. And the response very frequently is: "Well, that is why I do not raise the issue anymore; the last time I raised it, the response was, Look, if the employees do not want to match, that is fine, there will not be a match, or there can be a match in employer stock." They look at the staff: "You are my staff. You tell me—would you just as soon communicate to the employees that there is no matching contribution, or would you rather go ahead and do it in employer stock?"

"I as a CEO," they say, "believe in employee ownership. We have a defined benefit plan. We have other programs. They do not have to put their money in employer stock. This is my dedication to employee ownership."

So there are those kinds of complexities but also dramatic differences in the answers you will get depending on at what level you are asking a question within a company.

Senator WELLSTONE. This is very helpful.

Let me conclude—I and other members of the committee may want to get back to some of you—just for the record, Mr. Prentice—and I just want to get this on the record, and it is probably one of the reasons you came here to be on record—as the stock started plummeting in value, did the committee do any kind of evaluation as to whether or not the stock was a prudent investment? I ask you that because other companies—and I could give examples—have done so.

Mr. PRENTICE. If you look at the year 2001, we started off at about $83. I think we were still at about $80 in mid-February. From that point until the end of the year, it was basically a downward trend. We did not as an Administrative Committee do anything at that time because of several factors. The first factor was that the stock market in general was on a downward trend. There were other factors that were particular to Enron at the time. Enron was one of several Texas companies that was being blamed for the California energy crisis, and we were taking some knocks for that. We had made a major investment in broad band technology, and we were suffering with the rest of the technology industry and that downward spiral.

We had, in hindsight, made a very ill-advised entry into the water business, and that proved to be very disastrous. And we had over the last several years made a major investment in a large power facility in India, and the Indian Government decided that they did not want to honor the contract.

So we had had multiple hits to Enron in addition to the overall downward trend in the stock market. We were not happy with the trend, but we thought that the basics of the company were sound. Fellow committee members as well as myself also read the statements from Mr. Lay and other members of senior management, and we believed the company was sound. It was not until early November that we decided that we needed additional help, and we

needed to look into it, and that is why we took steps to hire a professional investment advisor.

Senator WELLSTONE. You are telling me what was affecting the value, but I was asking you when the actual evaluation of whether or not the stock was prudent took place, and you are saying not until much later.

Mr. PRENTICE. Yes.

Senator WELLSTONE. Now, the last question—the testimony of Cindy Olson, who was also on the Administrative Committee, was that she had reason to believe, at least going back to August of 2001, that the company was in precarious financial condition, and that is because she had apparently had a conversation with Sharon Watkins, the company employee who had written Mr. Lay about her fears that the company was going to "implode in a wave of accounting scandals."

Did Ms. Olson ever share any of this with you?

Mr. PRENTICE. No.

Senator WELLSTONE. I appreciate that.

Does that disappoint you? I mean, do you think that she had some responsibility to report this information to you and other colleagues?

Mr. PRENTICE. I think it would have been very interesting conversation, and had she brought it up, I do not believe that that is a function of the responsibility of the Administrative Committee. I feel like we would have advised Cindy to take that to the attention of Enron's legal counsel.

Senator WELLSTONE. I am not here to change the whole tenor of the meeting, and I have told you I thank you for being here, but in some ways, I just feel like part of what you are saying is, "Look, I did not really have any fiduciary responsibility here."

Mr. PRENTICE. That is not true. No, I am not saying that.

Senator WELLSTONE. OK. I wanted to be clear about that. That is the way I heard it, and it may not be what you were saying.

Mr. PRENTICE. I apologize. I did not mean that in any way, shape or form.

Senator WELLSTONE. Fair enough.

Let me thank all of you. Some of you, I want to definitely get back to if that is all right. We will keep the record open for 2 more weeks.

Thank you very much for being here. It is much appreciated.

The hearing is over.

[Whereupon, at 1:40 p.m., the committee was adjourned.]

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