THE PENSION SECURITY ACT: NEW PENSION PROTECTIONS TO SAFEGUARD THE RETIREMENT SAVINGS OF AMERICAN WORKERS

HEARING

BEFORE THE

SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS

OF THE

COMMITTEE ON EDUCATION AND THE WORKFORCE

HOUSE OF REPRESENTATIVES

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THE PENSION SECURITY ACT: NEW PENSION PROTECTIONS TO SAFEGUARD THE RETIREMENT SAVINGS OF AMERICAN WORKERS

Thursday, February 13, 2003

Subcommittee on Employer-Employee Relations

Committee on Education and the Workforce

U. S. House of Representatives

Washington, D.C.

The Subcommittee met, pursuant to call, at 1:00 p.m., in Room 2175, Rayburn House Office Building, the Hon. Sam Johnson, Chairman, presiding.

Present: Representatives Johnson, DeMint, Ballenger, McKeon, Platts, Wilson, Cole, Kline, Carter, Musgrave, Andrews, Payne, McCarthy, Kildee, Tierney, Wu, Holt and Case.

Staff Present: Christine Roth, Professional Staff Member; David Connolly, Jr., Professional Staff Member; Dave Thomas, Senior Legislative Assistant; George Canty, Counselor to the Chairman; Ed Gilroy, Director of Workforce Policy; Molly Salmi, Deputy Director of Workforce Policy; Kevin Smith, Senior Communications Counselor; Kevin Frank, Professional Staff Member; Deborah L. Samantar, Committee Clerk/Intern Coordinator.

Mark Zuckerman, Minority General Counsel; Michele Varnhagen, Minority Labor Counsel/Coordinator; Peter Rutledge, Senior Legislative Associate/Labor; Dan Rawlins, Minority Staff Assistant/Labor.

Chairman Johnson. The Subcommittee on Employer-Employee Relations will come to order.

The Subcommittee is meeting today to hear testimony on the "Pension Security Act: New Pension Protections to Safeguard the Retirement Savings of American Workers."

I am eager to get to our witnesses today, so I am going to limit the opening statements to the Chairman and Ranking Minority Member of the Subcommittee. If other Members have statements, they will be included in the hearing record.

With that, I ask unanimous consent for the record to remain open 14 days to allow Member statements and other extraneous material referenced during the hearing to be submitted for the official hearing record.

Hearing no objection, so ordered.

OPENING STATEMENT OF CHAIRMAN SAM JOHNSON, SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE

Today it is my privilege to Chair the first hearing on the Pension Security Act. Protecting the retirement security of Americans remains a key priority for all of us, and with a new Congress we have a real opportunity to send President Bush a comprehensive pension security bill he can sign into law.

We should not have to wait for another corporate scandal before we empower workers with new protections that can help them enhance and protect their retirement security. And we are committed to addressing the pension security of American workers. Workers ought to be fully protected and fully prepared with the tools they need to protect and enhance their retirement security.

The Pension Security Act will give millions of Americans new tools to help them better manage and expand their retirement savings.

This proposal:

- gives workers new freedom to diversify contributions of company stock after holding it for 3 years in their 401(k) accounts;
- provides employees access to high-quality professional investment advice;
- allows workers to purchase retirement planning services with pretax dollars;
- gives workers better information about their pension plans.

The measure also includes a number of provisions to make it easier for small businesses to start and maintain pension plans and would further protect employees by ensuring that statutory

stock options will not be subject to payroll taxes.

Last year, the Full Committee held three hearings over 4 days to examine the collapse of Enron and how to better protect pension participants. We heard testimony from administration officials, pension experts, employees. The theme that emerged was that people need more resources to effectively manage their retirements.

Enron, like most companies, did not provide its employees with access to investment advice. Neither did they pay very much in income tax. The Pension Security Act would fix outdated Federal laws to allow employers to provide their workers with high-quality professional investment advice as an employee benefit, while making advice providers personally liable for any advice not provided in the employee's best interest.

Millions of employees who have seen their 401(k) balances dwindle might have been able to preserve their retirement savings if they had access to a qualified advisor who would have warned them in advance that they needed to diversify.

Besides providing investment advice to workers, the Act includes new, important measures that give employees the freedom to diversify their portfolio and provide employees with a benefit statement.

More important, the bill strikes a critical balance between providing retirement security for workers, providing privately held companies a source of capital and providing workers ownership through ESOPs.

Under the bill, employees may sell company stocks and diversify into other investment options after they avail the company stock for more than 3 years. In addition, it requires companies to give workers quarterly benefit statements that include information about accounts, including the value of their assets, the right to diversify and the importance of maintaining a diversified portfolio.

I am proud that we are moving forward with the Pension Security Act as a bipartisan measure, and I am hopeful that we can continue to work with our Democrat friends to reach consensus on the pension reforms that I have just outlined.

Last year, the House acted quickly in the face of corporate scandals to protect American workers' retirement by passing this plan. Unfortunately, the Senate did not even consider it. With the makeup of the new Congress, I think the time for this bill has come!

WRITTEN OPENING STATEMENT OF CHAIRMAN SAM JOHNSON, SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE – SEE APPENDIX A

Chairman Johnson. Today, the Subcommittee will hear from two panels of witnesses on the subject of pension reform. Our first witness will be Assistant Secretary of the newly named, Employee Benefits Security Administration, at the Department of Labor; and the second panel

represents plan sponsors, service providers and pension experts. Both panels have an interest in any pension legislation.

The Nation's employer-based pension system is essential to the security of American workers, and we should move quickly to finish the good work that we began in the last Congress and restore confidence in our pension system.

I now yield to the distinguished Ranking Minority Member of the Subcommittee, Mr. Andrews, for whatever opening statement he wishes to make.

Mr. Andrews. Thank you, Mr. Chairman.

I want to begin by publicly honoring the Subcommittee Chairman of this Subcommittee on the day after the 30th commemoration year of a day of liberation for him. Sam Johnson, for those of you who do not know, served this country with incredible nobility and bravery in the Vietnam conflict and spent, if I am not mistaken, 7 years in a north Vietnamese prison camp. Yesterday was the 30-year anniversary of his release.

Sam, none of us would be sitting here without the bravery that you showed; and I just want to personally thank you for giving us the privilege of living in freedom in this country. Thank you.

I also want to take a moment and introduce two students from my district that are visiting with us today. I was supposed to meet with them personally during this time, but it is my responsibility to attend these Subcommittee hearings. Chen Chang and Colin Martin are with us today from the Congressional Youth Leadership, and I welcome them to the Subcommittee.

I also wanted to say to our new colleague, Mr. Ed Case, representing Hawaii that we welcome him to the Subcommittee and look forward to his participation and active role on the Committee.

OPENING STATEMENT OF RANKING MEMBER ROBERT ANDREWS, SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE

We are meeting at a time when what is essentially a very sound pension system is faced with three of the greatest challenges that I think it has faced since 1974 when ERISA was enacted.

The first challenge was dramatically illustrated by the collapse of Enron and other pension problems that occurred, which affected thousands of other workers around the country in recent times. That problem has many dimensions, but I think the first and foremost among them is embedded in our shift from plans that are run by boards of trustees to plans that are run by individuals through 401(k) and other individually managed accounts. There are a host of issues surrounding that: How people can get appropriate advice? How they can be given a full range of

options to manage their money as they see fit when the time comes? And I know that the proposals that the majority has put forward address that. We, too, have proposals that address that; and we look forward to debating and discussing and negotiating them.

Second problem is that at a time of significant weakness in our economy, corporations around our country are being compelled this year to put billions of dollars into pension contributions because of the severe downturn in the financial markets. It is hard to think of a time when corporate America has been less able to take billions of dollars out of circulation than today. But the realities are that the under funding of plans that exist because of the downturns in the market has created not only a severe crisis in many pension funds but a real drag on the U.S. Economy. It would be the supreme irony that at the same time we debated and eventually enacted stimulus legislation that we undid all the good that any stimulus legislation may do by taking huge amounts of money out of circulation through necessary pension fund contributions. It is a real problem we have to address.

Finally, a problem that is not new but deepens in intensity is the fact that nearly 70 million Americans who will go to work today have no pension at all. And if medical technology continues to advance as I hope and pray and assume that it will, in a few decades America is going to be a place filled with 85- or 90-year-old people who have only Social Security. That is a recipe for a new generation of impoverished Americans who are, in many cases, unable to go back to work because of age and in most cases probably unwilling to go back to work unless it is absolutely necessary. People who have paid their dues and raised their families and paid their bills for generations are going to find themselves back in the workforce at a very advanced age because they will have no other option.

It is our responsibility to answer these and other questions, and I look forward today to being the first in what I hope will be a series of efforts during this Congress to come to grips with those problems. I don't believe that they require or lend themselves to partisan approaches. I think there are many areas in this part of our policy where we can come to common understanding. I hope, knowing the good faith of the Chairman of the Subcommittee, that we will be able to do that.

We have some very significant objections to the bill that is before the Subcommittee, and we have ideas that we believe should be brought before the Subcommittee. But I hope that today will be a first step toward reconciling those views and ideas, and I look forward to hearing from the witnesses.

Chairman Johnson. Thank you, Mr. Andrews, and thank you for your earlier comments. I appreciate that. And I think I agree with his comment that this is the greatest Nation in the world and were it not for our military men and women today we would not be free and have the freedoms that we enjoy and the ability to agree to disagree.

We can talk about these bills, and he is right. We are in an area where there should be some agreement. So I hope that with this hearing and further down the road during the markup we can come to some accommodation and especially on those other issues we discussed in the future. Thank you for your comments.

Our only witness on the first panel is the Honorable Ann Combs. As all of you know, Secretary Combs is the Assistant Secretary of the Employee Benefits Security Administration, formerly known as the Pension and Welfare Benefits Administration. That is a mouthful, but I will tell you what, she is the number two lady over there in the Labor Department and does a great job for America.

Before her appointment, she was Vice President and Chief Counsel, Retirement and Pension Issues, for the American Council of Life Insurers. During the Reagan and prior Bush Administrations, Ms. Combs spent 6 years as Deputy Assistant Secretary of Labor for the above EBSA. Her previous experience includes the National Association of Manufacturers and PriceWaterhouse, Inc. A graduate of the University of Notre Dame, Ms. Combs also holds a J.D. from the George Washington University Law School here in Washington, D.C.

On behalf of the Subcommittee, I welcome you today. I don't think I have to explain the light system. You are aware of it.

So, Madam Secretary, you may begin your testimony.

STATEMENT OF THE HONORABLE ANN L. COMBS, ASSISTANT SECRETARY, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, U.S. DEPARTMENT OF LABOR, WASHINGTON, D.C.

Thank you. Good afternoon, Chairman Johnson, Ranking Member Andrews and other Members of the Committee. Thank you for inviting me here today to discuss the Bush Administration's proposals to strengthen the retirement security of American workers, retirees and their families.

As you have mentioned, Chairman Johnson, last week Secretary Chao did change the name of our agency to the Employee Benefits Security Administration. This was done to make our agency's mission more recognizable to the people we serve, in particular the rank and file workers and their families who rely on us for advice and assistance in securing their benefits. Last year, we assisted a record 184,000 American workers and achieved record monetary recoveries through enforcement actions in both pension and health care plans.

The recent revelations of corporate and union malfeasance, combined with the challenging economy, have heightened Americans' concerns about our private pension system. The Bush Administration has a comprehensive agenda combining tough enforcement with both short- and long-term reform proposals to improve and strengthen the private pension system.

Today you have asked me to specifically focus on the Pension Security Act, so that is what my remarks address.

Congress made a down payment on improving retirement security by passing a portion of the President's Retirement Security Plan last year in the Sarbanes-Oxley Act. We are pleased that

the Chairman has made passing the remainder of the Pension Security Act an immediate priority for this Congress.

The Sarbanes-Oxley Act, as you know, contains two key provisions from the President's plan. First, workers will now receive 30 days notice prior to a pension plan blackout period, enabling them to plan accordingly and to make necessary decisions about asset allocations, distributions or loan applications. Second, corporate officers are now prohibited from selling their own company stock during a blackout period.

But the American people deserve the benefits of the remaining proposals of the President's Retirement Security Plan as well. This plan would give workers more freedom to diversify their investments, provide better disclosure to workers through improved individual benefit statements and provide access to professional investment advice.

We all agree that increasing workers' ability to diversify their retirement savings would benefit workers, retirees and their families. The President's plan would ensure that workers could sell company stock contributed on their behalf and diversify into other investment options after they have been in the plan for 3 years. A recent survey by Hewitt Associates indicated that 62 percent of companies already have or are considering easing employer stock restrictions. This is good news, but we need to make sure that all workers are able to choose how to invest their accounts.

A meaningful ability to diversify also depends on workers receiving timely information about their 401(k) accounts. The President's Retirement Security Plan would require companies to provide workers with quarterly benefit statements, including information about the value of their assets, their right to diversify and the importance of maintaining a diversified portfolio.

As noted by Mr. Andrews, the pension investment world has changed over the past 25 years, and workers are increasingly responsible for managing their own retirement accounts. Individual Americans now have primary responsibility for investing approximately $2 trillion in retirement savings through defined contribution plans, and they need help. ERISA currently has barriers that prevent employers and investment firms from providing individualized investment advice to workers; and, as a result, millions of Americans do not have the information necessary to make sound investment decisions.

The President's plan would increase workers' access to professional investment advice. By relying on expert advisors who assume full fiduciary responsibility for their counsel and by disclosing relationships and fees associated with the investment alternatives, workers will be better equipped to make better retirement decisions. And, frankly, American workers not only need but they want more advice. A recent survey by CIGNA Retirement Services indicated that 89 percent of 401(k) holders want specific information on investment decision-making.

The Department took a first step towards making investment advice more available last year when we issued an advisory opinion to SunAmerica that provides a model for independent investment advice. While this is extremely important, the opinion does not address all of the

barriers that workers face.

For example, when a worker receives specific recommendations generated by an independent advisor and then delivered by the financial service provider, the worker can't consult with the financial service firm to question or deviate from the recommendations. The financial services firm cannot discuss its own products with the plan participant because of ERISA's prohibited transaction rules. So the worker is left with the take-it-or-leave-it choice of accepting the advice that is generated by the independent model or has to make decisions on their own, again without the benefit of advice.

Equally important, the Department of Labor does not have the ability to address the problem that employers continue to be uncertain about their liability for investment advice that is given by third parties to their workers. Legislation is needed to address the liability concerns of plan sponsors who are otherwise reluctant to make advice services available.

The investment advice proposal in the Chairman's bill includes important safeguards to ensure that workers receive quality advice that is in their best interest. Only qualified fiduciary advisors that are fully regulated by applicable banking and insurance and securities laws would be eligible to provide advice. Investment advisors who breach their fiduciary duty would be personally liable for any failure to act solely in the interest of the worker and would be subject to civil and criminal penalties. It would be illegal for a fiduciary advisor to make investment recommendations in order to increase their own compensation. Advice providers also would have to clearly disclose any fees and potential conflicts.

Simply put, plan sponsors and their employees need more investment advice options; and that is why the President strongly supports the Chairman's legislation, which has been passed twice by the House in the 107th Congress with strong bipartisan support.

In closing, let me again urge the Subcommittee to pass this legislation. Taken together, the ability to make unrestricted investment decisions with the confidence that comes from having good information and professional investment advice will give workers the choices, the confidence and the control that they need over their retirement savings.

Mr. Chairman, this completes my statement. I would be happy to answer any questions that Members of the Subcommittee may have, and I would ask that my written statement be submitted for the record.

WRITTEN STATEMENT OF THE HONORABLE ANN L. COMBS, ASSISTANT SECRETARY, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, U.S. DEPARTMENT OF LABOR, WASHINGTON, D.C. – SEE APPENDIX B

Chairman Johnson. So ordered. Thank you for being here.

I understand the Department has been involved in a lengthy investigation into the Enron case. Can you comment on the progress you have made?

Ms. Combs. I can, Mr. Chairman; and I think it is a fair question. We have been asked why has the Enron investigation has taken so long. There are several points I would like to make.

One, we have taken specific actions to assist the workers in the Enron situation. We appointed an independent fiduciary to replace the corporate officers who had been serving as fiduciaries of the plan. State Street Bank is now serving as the fiduciary of the retirement plans for Enron workers. We also filed an amicus brief in private litigation laying out the Department's view of the law and how ERISA applies to situations like Enron, and I think our brief in that case served not only to benefit the workers in Enron but workers across the country. I think it has had a major impact on corporate plan sponsors. I think they have taken a good hard look at the systems they have in place and how they are meeting their fiduciary obligations.

That being said, the investigation is ongoing. It is an extremely complicated investigation. We are working closely with the Securities and Exchange Commission and with the Justice Department. I am hoping that we will be able to conclude our investigation soon and take whatever the next appropriate steps are. But, beyond that, I can't really talk about the specifics of the investigation, other than it is hopefully coming to a conclusion soon.

Chairman Johnson. Good.

While the Pension Security Act was a response to corporate misconduct, I am curious about the agency's investigation into another type of misconduct. Can you let me know what is happening regarding the investigation into the mess with Ullico and Global Crossing and the pension funds of the AFL-CIO union members?

Ms. Combs. As you know, and as I testified before this Subcommittee previously, we generally don't talk about ongoing investigations unless there has been a public action that has been undertaken so it is on the public record; and because we just recently took such an action in the Ullico case, I can confirm we do have an investigation. We filed in court just this week to enforce a subpoena that we had issued to Ullico and its officers trying to seek additional information and documents including the report that was issued by former Governor Thompson.

Ullico failed to comply with our subpoena so we went to court yesterday. And just this morning I learned that we have a hearing scheduled for next week, which is very quick. So we are moving to enforce that subpoena and continue the investigation. But, beyond that, I can't talk about specifics of what is going on in that investigation.

Chairman Johnson. Well, as you know, I am always concerned about creating too many requirements for businesses. Small businesses in particular have trouble meeting them. I am concerned that additional plan requirements would discourage employers from offering plans. Can you tell me what provisions in the Pension Security Act would help the Department of Labor tailor requirements for small businesses, and would you be able to help small employers meet the

requirements and protect participants?

Ms. Combs. Yes. There are several provisions in the bill that are designed to ease the burden on small business, in particular, the requirement to provide quarterly benefit statements with information about the accounts. I think the Act specifically acknowledges that the Secretary can take steps to make sure that the reporting burden reflects the needs of small business. For instance, it doesn't require that they value their assets quarterly. One of the provisions is that an annual valuation can be used.

I also believe that the investment advice provisions in the bill will be helpful to small business. As I mentioned in my testimony, we have given an opinion about the use of independent advisors, and that is a terrific option and one that tends to be more broadly available to larger employers.

Small businesses, for instance, don't tend to want to have to contract with a number of individual vendors. So if they can go to one institution for all services, they would be more likely to make investment advice available to their workers. So I hope that will be a benefit to the small employer.

Chairman Johnson. Thank you.

Mr. Andrews, you care to inquire?

Mr. Andrews. Thank you, Mr. Chairman, and Madam Secretary for your testimony.

About a year ago, the Full Committee heard testimony from an Enron employee who had seen his 401(k) balance drop from about $600,000 down to about $14,000. As I recall, virtually all of his account was held in the stock of his employer at Enron.

We also heard during those three hearings what I thought to be astonishing testimony that indicated that people in a fiduciary capacity in that plan had not only failed to disclose material information to the plan participants but themselves had acted upon that material information to divest themselves of their own holdings at the same time the ship was sinking.

I believe it was you who came back to the Subcommittee in the middle part of 2002, and we asked the question the Chairman just asked about enforcement actions by the Department of Labor. I want to revisit his question of today and ask why it is that, more than a year after those revelations and by my count about seven or eight months since the Department was last here before this Subcommittee, no enforcement action has been undertaken under existing law.

Ms. Combs. I think that is a fair question, Mr. Andrews. It is frustrating to all of us who have been involved with the Enron situation and others. We have worked very diligently and have taken a lot of action. It is, as I said before, an extremely complicated situation.

You referenced the hearing about the tax and accounting practices of Enron. These were a very, very difficult set of facts to wade through, understand and follow the trail, if you will, to

conduct this investigation. We are cooperating with the other Federal agencies involved in this as well.

Mr. Andrews. Have any of those Federal agencies filed civil actions on behalf of the plan participants?

Ms. Combs. There have been private cases, but none of the other government agencies have brought their cases yet, to my knowledge.

Mr. Andrews. Here is my concern. I agree with you about the complexity of this case, but I think you would also have to agree with me that assets that might be subject to judgment are much more likely to evaporate and disappear. And I am not talking about assets of the plan; I am talking about personal assets of defendants that might be called into cases of this nature. It is incomprehensible to me that we have waited more than a year to do something about this.

The question that I worry about is a rhetorical question, but I think it is going to make a big difference in the lives of people like Mr. Padgett who testified here a year ago. How many assets move beyond the reach of civil judgment in that year's time that might have been there to back up a judgment that could have been entered against the guilty parties should they be proven guilty in that case? I understand that when there are criminal investigations going on, civil remedies sometimes have to take a back seat.

I understand that this is a very complex case. But I also understand that you are giving us precisely the same answer that you gave us eight months ago. The case did not get any more complex in the last eight months and the assets didn't get any easier to recover. When can we expect the Department to disclose publicly whether it will pursue a civil action here or not?

Ms. Combs. I am very hesitant to give you an exact date, because I don't have an exact date. I don't know the answer to that question. We are wrapping things up. I realize that I am giving a response similar to what I gave eight months ago when asked similar questions. What can I say to the Subcommittee, because you deserve a fuller answer? But we are not there yet, and it is difficult. You can't compromise an investigation by talking about it and putting it at risk.

I am confident that we will do it soon. I don't want to put an exact date on it because, as I said, I don't know the exact date. You are right. It is a question of balance making sure those assets are preserved and that recoveries are possible. We also want to have an airtight case or as strong a case, I should say, as possible, if and when we do move, so that we are successful. And I think we are at a point where we will be taking action soon.

Mr. Andrews. Frankly, I can only say if the same fiduciary standard that applies to ERISA trustees applies to the Department in terms of protecting the assets of those you are entrusted to protect, I think the Department could be sued for breach of fiduciary duty.

If a plan trustee waited more than a year to vigorously pursue the disappearance of assets, I think the Department would hold that plan trustee under the terms of ERISA. And I mean no

disrespect, but I find your answers to be wholly unsatisfactory.

Ms. Combs. I am not sure there is evidence that assets are disappearing, and I know the Justice Department has moved against certain people who are the subject of various investigations to preserve their assets. Certainly we are anxious to make sure we maximize the recoveries to the extent that we can, and I understand your frustration.

Chairman Johnson. Could you tell me if you are having problems with Judiciary on this?

Ms. Combs. It has been a very cooperative relationship. And it is not just the SEC and Judiciary, it is also the IRS and FBI.

Chairman Johnson. But is the coordination aspect between all those agencies being done efficiently?

Ms. Combs. It is being done very efficiently. I think our investigators and our lawyers would both say there are several task forces that are working well together and sharing information. Some of it is just a practical task. Everyone needs to depose the same people, and I think getting all of those things organized for a case that is as complex as this is, it has worked very well. We don't have any complaints.

Chairman Johnson. Mr. Cole, do you care to inquire?

Mr. Cole. Yes, sir, Mr. Chairman. Thank you very much.

Ann, it's good to see you. I have just a couple of quick questions. If the legislation in question had been in effect during the Enron debacle, what would have been the consequences? Would we have been able to avoid most of the negative consequences?

Ms. Combs. Well, I think that is an important distinction. This legislation is not designed nor would it have prevented the accounting irregularities and malfeasance that allegedly took place at the Enron Corporation. However, there are several things in this legislation, which would have improved the situation of the workers, and their retirement plans.

For instance, in the Enron plan, they were not allowed to diversify out of company stock. The matching contributions in their 401(k) plan were made in company stock, and they were able to purchase additional shares. They couldn't diversify out of their matching contributions until they were age 50. This would be a significant change so they would have had more ability to sell.

I think they would have benefited greatly from investment advice. Many of the participants in the Enron plans, frankly, were heavily concentrated in their employer's securities and had they had professional advice about the value of diversification, and better information about what was happening, that certainly would have been to their advantage.

Obviously, as we said in our amicus, ERISA already requires that the information they are given by their management be accurate information, and that the fiduciaries act in their interest and

protect their interests. That is what the investigation is about, whether they met those standards, but I think the bill would have helped.

Mr. Cole. So in your opinion this would have significantly enhanced the protections available to workers at Enron had we had something like this in effect?

Ms. Combs. Yes, I think this would have.

Mr. Cole. Was there legislation like this proposed by previous administrations?

Ms. Combs. I don't believe there was, not to my knowledge.

Mr. Cole. So we are breaking new ground here in response to a crisis or a problem or that terrible situation that broke upon us rather suddenly in 2001?

Ms. Combs. I think that is a fair statement, yes.

Chairman Johnson. I think, if you will allow me, the idea has been around for a while but that brought it to the forefront.

Ms. Combs. Investment advice had been discussed.

Chairman Johnson. You have been hearing that noise. That is not the Martians coming. It is the wind blowing through the windows behind us, and we can't stop it. Maybe our Department of Labor could find somebody to fix it.

Ms. McCarthy, you care to inquire?

Ms. McCarthy. Yes, I would, thank you, Mr. Chairman.

I just want to change the subject a little because there are a number of complaints that I am getting from some of my constituents on the cash balance pension plan. We know that some companies have already made accommodation for the older workers that have been there for 20 or 30 years, but I am concerned about what input the Department had on the controversial proposals of the IRS regulations permitting cash balance pension plan conversions without protections for older worker pensions? This I know is a controversy with an awful lot of people. Obviously those workers that have been there 20 and 30 years do get hurt with this conversion. What is the Department basically looking into, as far as that goes?

Ms. Combs. The regulations you mentioned, as you rightly said, were issued by the Treasury Department. They have the responsibility for interpreting those portions of the Tax Code that deal with benefit accruals and things that were at issue in the application of the age discrimination rules on cash balance plans. The Administration has a coordinated effort at the Department. Our staff did review those regulations to see what implications there were for areas under our jurisdiction, through technical review, but the regulations were developed by the Treasury Department, and they

are going to have hearings.

I think regulators need to give guidance to the public. I think it is important they put the regulations out and they get input from the public, and I am sure they will be hearing from all interested parties on those.

We are concerned about workers and the effect of transition. The Department's role has been on the disclosure side, working with the Treasury. Treasury actually has the responsibility for the official notice, but we have been working closely with them on that.

As you may know, our Inspector General looked at several cash balance conversions, and we are waiting for guidance from the IRS as to how they apply interest rates and conversions. We are concerned about the issue Mr. Andrews was talking about. The switch from defined benefits to defined contribution plans raises a lot of issues, and cash balance plans are defined benefit plans. They have a lot of benefit for employees. The risk is on the employer. The Pension Benefit Guarantee Corporation insures them.

But you are right. This transition issue in the conversion does have a major effect on people who are near retirement, and we need to look carefully at those issues and make sure that they are protected.

Ms. McCarthy. Just to follow up on that, I was just handed this. This came from the Department of Treasury basically to this Subcommittee. The IRS and Treasury have not issued regulations or guidelines on lump sums paid by cash balance plans. So, apparently, they have given you the information. Am I reading this correctly? Actually, the IRS is saying that they have given you the guidance.

Ms. Combs. I am not familiar with the letter that you are referring to. But we checked as recently as last week, I believe, about the status of their guidance to us; and they have yet to tell us how they apply the conversion; the lump sum rates on the issue. We can look into this and answer for the record, but I am just not familiar with it.

Ms. McCarthy. I am going to give you a copy of this. This is going back to December of 2002.

Ms. Combs. Let me just ask. We will take a look at it and give you an answer in writing.

Ms. McCarthy. I am hoping that you might look at those companies that basically have, in my opinion, been very good to their workers, because they have, as far as the complaints, taken care of their older workers.

Obviously, to all of a sudden lose quite a large lump of money when approaching retirement, people like me thought we would retire at 55, are now looking at 67. That is a big difference. But for those older workers that thought they could retire and now can't, we really have to do a little more to protect them.

Thank you.

Chairman Johnson. Thank you.

Mr. Ballenger, do you care to inquire?

Mr. Ballenger. Yes, if I may.

Ms. Combs, have you read the latest Fortune magazine story about Ken Lay and what he did at Enron? The question all of a sudden arises that maybe he didn't do anything illegal because when he spoke and said he thought the stock was under priced and you should buy, he was buying, but at the same time, because of margin costs, he was selling. And the news media made the fact that he was selling at those times into an indictment against him.

I don't know whether our friends will say that this case should be decided quicker. They ought to read that story because, in reality, I think he needed some investment advice to quit buying his own stock if the guy just didn't have enough brains to realize that it was going down the tubes. But the basic idea that he evidently, seriously believed when he told his employees that it was a good buy because it was selling far too low was evidently sincere. Have you heard any of that?

Ms. Combs. I didn't read the Fortune story, but I read reports of the story. And we have to establish facts, and that is why investigations take a long time. We take depositions and put people on the record under oath and establish facts. It is hard to speculate on the media reports and what he believed or didn't believe. Those are very difficult issues.

Mr. Ballenger. That would make it complicated for lawyers even, and lawyers don't understand money anyhow except on the collecting end.

Let me just say, having started off with a profit-sharing plan, which I gave to my employees that turned out not to be a very good plan because some years you don't make any money and they had been used to getting money, I had to do something else. I came up with a defined benefit plan and had that arranged for my employees. I ran into government regulations, and then all of a sudden ERISA was enacted, and scared me to death. I thought to myself, pretty soon the government is going to tell me how and what I have to put in. So I liquidated that and gave it to my employees and went into a defined contribution plan. And now it appears that the cash balance plans are going to take care of that one, too.

Do you feel somewhere along the line that if the Federal Government keeps involving itself in various and sundry benefits that an employer gives an employee, employers are just going to quit giving those benefits because the Federal Government is going to step in and change the rules after you already started the thing?

Ms. Combs. I think it is a balancing act. It is a voluntary system, and employers don't have to provide these retirement savings plans for their workers. There need to be protections put in place. We need to have regulations and have enforcement and rules. But we have to balance that against

an employer's willingness.

I think we have over the years layered on a lot of complication. I think there is much we can do, working together, to simplify the law. In some way just the constant change is a disincentive for employers.

So it is an issue we can work on together to try to strike that balance, and simplification is desperately needed.

Mr. Ballenger. The sad part about it is that you mentioned what the majority of the news media and everyone else doesn't seem to recognize, and that is it is a voluntary benefit that employers can either give or not give. I think in a competitive world in order to get the best employees you can get, you come up with plans that try to top what someone else has offered. And all of a sudden you run into "9/11" and the economy collapses and everything costs more than you thought, and then you try to figure some way out of your over commitment.

Steel companies and automobile companies are all deeply in debt, and their pension plans are killing them. It is very difficult to change it.

Ms. Combs. It is difficult.

Mr. Ballenger. That was a completely unbiased statement on my part.

Chairman Johnson. Thank you, Mr. Ballenger.

Mr. Case, do you care to inquire?

Mr. Case. Yes, Mr. Chairman.

As a lawyer, I will attempt to demonstrate my knowledge of money issues over and above collecting.

Madam Secretary, thank you. Welcome to the Subcommittee. I agree that the bill takes a step in the right direction in many areas, but I would like to refocus on the professional investment advice portion of this because I think that probably is the most sensitive part of the bill; and judging from the devotion in your oral testimony on this one point, it appears to be quite sensitive. So let me ask you the basic question, and my sub questions are designed to ask you the question, why is it necessary we do this right now?

My understanding is that, under the ERISA laws at the moment, we have some pretty strict barriers to the ability of employers and firms providing pension services that provide independent investment advice to their employees. It is pretty tight, isn't it? You can't do it under many situations.

Ms. Combs. They are independent investment advisors if you use a third party who is unrelated to the plan options or the financial service provider. When firms are also sponsoring some of the

investment options in the plan, there is a very strict prohibition.

Mr. Case. And the advisory opinion that you referred to, first of all, I assume if it was an advisory opinion, that what you have set up and authorized under that advisory opinion is compliant with law. And I think a very important part of that advisory opinion, if I am not mistaken, is that each of these advisors when they take advantage of the safe harbor under the advisory opinion actually hire an independent financial advisor to look over their shoulder, right?

Ms. Combs. They actually contract with an independent. In the case of SunAmerica it was Ibottson who develops an asset allocation model if you will. Ibottson feeds in the individual participant's information, demographic information, and risk tolerance and produces an optimal investment portfolio. Then the financial services firm presents that to the individual, but they can't deviate from that. The financial services firm can't say, well, if you aren't comfortable in the international fund, you can do this instead. That is the limitation of the opinion.

The opinion opened up a lot of access to advisors, and I am proud of it, but I think there is more that we need to do.

Mr. Case. Fundamentally, what that opinion said was that you need to retain the independent advice to the entity that is taking advantage of that opinion, right?

Ms. Combs. Under current law, that is a requirement.

Mr. Case. And under the bill as proposed, that is gone. You don't have to have that independent advice anymore.

Ms. Combs. That is right. Under the bill, in this instance SunAmerica itself, the SunAmerica advisor could sit down with the worker and say, well, if you are not comfortable with this portfolio that has been produced by the model we can tweak it, we can adjust it. This bill would allow that to happen. That can't happen now.

I hate to use them as an example.

Mr. Case. You take out the third party.

Ms. Combs. You could.

Mr. Case. What is the policy reason for doing that? And let me go a step further. Your testimony says that current law raises barriers against them providing individual advice; and you go on to say, as a result, millions of rank and file workers don't have the information and advice necessary.

Is there any lack of independent information and advice available to workers who want advice? I mean, I could see this if the only people out there providing investment services were the very same people that were the employers or that were starting up these pension plans, but my understanding of this industry is that there are a lot of people out there wanting to give advice. Is

there a shortage of people available to give independent advice?

Ms. Combs. There are people who are able and willing to give independent advice. But consolidation in the financial service industry has made this more of a problem because a lot of people are related to one another, which causes them to violate these rules.

Mr. Case. Just to follow up on that, this bill would facilitate more consolidation, right? Because it would really drive the independent advisors back under the umbrella of these very same companies that now can have a one-size-fits-all, drive-in, get-everything-you-want kind of model.

Ms. Combs. Personally, I think the independents will remain that way. I think there is a niche for independent advice. I think it is good service. But what we hear is that there is not a lot of take-up among employees because it is often Internet based and pretty sophisticated. You have to sit there and fill in a lot of information. What they really want at the end of the day is to sit down across from a person or pick up the phone and ask what should I do. And so this is another option.

Independent advice, I think has its niche. I think it will continue as a viable option. But the intent of this bill and what we would like to see is more options made available for that small employer who just wants to make one stop and go to a Fidelity or a Vanguard or someone and have them take care of the whole process.

Mr. Case. They can do that right now under the advisory opinion, that "one stop."

Ms. Combs. It is more than looking over their shoulder. They have to generate the advice. They could. But again using as an example an advisor from Fidelity or Vanguard or SunAmerica or Prudential who is on the next panel, they couldn't sit down and say, here is what our model produced for you. Are you comfortable with it? Is there anything else you would like to do instead? That is what they can't do, and that is what they want to do. They want to provide that very individualized, very personalized point of contact.

And I think that is what most people we hear about are comfortable with. What we really want to do is get the advice to people, and we want to help them be better informed and help them make better decisions. So I think we want to get services out there that they can and are willing to access and use.

Mr. Case. My time is up, but I would suggest that the timing of doing this is wrong under the circumstances, and perhaps it needs to be thought through a little further.

Thank you.

Chairman Johnson. Gentleman's time has expired.

Mr. Kline, do you care to comment?

Mr. Kline. Yes, thank you, Mr. Chairman; and thank you, Madam Secretary, for being here and for the thoroughness of your responses to our questions. I want to follow up on what my colleague

was just talking about.

Mr. Case was pursuing the notion of investment advice. And in response to an earlier question you addressed the complexity of dealing with the Enron case and the many government agencies that are involved, the FBI and so forth. It seems to me that the investment advice portion of the Pension Security Act is an important part of it. Can you talk to us about how that will be enforced, keeping the investment advice legal? Who is going to be responsible and how is that going to work?

Ms. Combs. There are several safeguards in the legislation.

First of all, you have to be a qualified advisor, and that means you have to be regulated by the banking institutions or the FDIC or the broker dealers or by State insurance law if you are an insurance agent. So the person giving the advice is subject to professional regulation.

Most importantly, they have to acknowledge that they are acting as a fiduciary, which means they have an obligation to act only in the interest of the person whom they are advising. That is under ERISA, and we enforce those rules. Financial institutions take fiduciary responsibility extremely seriously. They realize that if they violate the fiduciary roles, they are not only personally liable but we often seek and do often get bans on them serving as fiduciaries in the future, which is a career killer if you are a financial institution. So that is a serious sanction as well.

And there are all sorts of reporting and disclosure provisions. They have to disclose their fees. So there is a whole statutory framework established to make sure people are aware.

Mr. Kline. In your judgment, would the enforcement of this portion of the Act be pretty straightforward and not lead to those complications that you discussed earlier despite the fact that there is a whole scheme?

Ms. Combs. Correct.

Mr. Kline. Mr. Chairman, I yield back.

Chairman Johnson. Mr. Payne, do you care to inquire?

Mr. Payne. I have a short inquiry. Let me thank you for your testimony, Secretary Combs. And I thank the Chairman for calling this very important hearing and the Ranking Member for being right on top of this issue. The ability to present to employees a plan and then to sell it is the crux of what has been a debate for a number of years

Very interestingly, I think Mr. Case as a new member, astutely saw one of the contentions. I am not going to deal with that issue right now. I just want to get back to some of the discussion about the defined benefit as opposed to the defined contribution plan, which we currently have.

In the old days, the defined benefit was the way that most companies went. And coming from ACLI, I know you are familiar with actuarial and actuarial statements. These benefits were not just done willy-nilly. They were based on the present value of future needs and the whole question of how actuarially we come up with amounts that would come out at a particular time. And I don't know why all of his plans failed.

But I do believe that the government should have stepped into the issue when many small businesses had plans in which revenue was taken from the company, or a CEO or executive officer of a small business could have a plan that would give them, say, 20 percent of their earnings for retirement but other employees might get 5 percent. I mean the government needed to step in. The government didn't step in just because they were looking for something else to do, and they stepped in to ensure an equal and fair distribution of retirement income.

I just mention that about defined benefits because, as you know, a week or so ago the United Steelworkers were told that their health care and their pension benefits would simply be totally eliminated because Bethlehem Steel is selling their company and they simply eliminated any benefits. It is just very harsh for beneficiaries to find out that they have no longer have benefits.

Do you believe that profitable companies that have promised, of course, Bethlehem Steel is far from profitable at this time, a certain level of retirement income should be able to renege on the promises that they make at this time as they move forward or should there be some adjustment so that they can use their actuarial information to determine where they stand?

I mean to get a letter, say as of Friday, that you have no more health benefits and no more pension benefits like the Bethlehem steel workers got last week is almost criminal. And some assistance from the government should be part of it.

People feel that government is best which governs least, and that is great. However, in this instance, there is a need, I believe, for the government to take a look at this. What are your views on that?

Ms. Combs. Well, in the Bethlehem situation, I would just point out that the company is in bankruptcy, and did terminate its plan. The Pension Benefit Guaranty Corporation (PBGC) has assumed that plan, and so the retirees will be receiving benefits from the insurance system. There is a limit on the guarantee, I think it is approximately $44,000 a year now, but some people receive less than that depending on their age and, as you said, it is actuarially factored in. But there is a Federal safety net for companies that terminate in an under funded situation, when they are in bankruptcy and in distress.

Retiree health is a different situation. There are no requirements that retiree health benefits be funded. There is no insurance program for retiree benefits. It really is a contractual obligation between the employer and the workers. And the employers, if they have reserved in their plan the right to terminate it or cancel it, can do that. There are some provisions that you all passed last year to expand the Trade Adjustment Assistance Act that would provide a health care tax credit up to 65 percent of the cost of health care for people whose benefits are being paid by the PBGC. So those Bethlehem retirees who are receiving benefits from the PBGC will receive assistance in purchasing

health care through a Federal tax credit.

So, there are programs that are in place. But it is a bad situation and one that we don't like to see happen. The Administration is currently working on proposals to improve and shore up the defined benefit system. There are several approaches. We want to make sure that promises that are made are kept and that pensions are well funded. We want to make sure that the interest rate used to replace the 30-year Treasury rate that is expiring, is an accurate interest rate that reflects the true liabilities of the plan. We need to make sure there are transition rules so companies can get on the right path. The insurance system's integrity is shored up and preserved, and that there is transparency so that people are aware of the funded status of their plans.

When Bethlehem terminated I understand that it was only about 50 percent funded. I don't know the exact number, but a plan shouldn't be in that kind of situation. We need to work together to make sure that promises are kept.

Chairman Johnson. Thank you, Mr. Payne.

Mr. Platts, you are recognized for 5 minutes.

Mr. Platts. Thank you, Mr. Chairman. I will be brief. I need to run off to a organization meeting for Government Reform.

I want to thank Madam Secretary for being here and for the information you shared with us, and also thank the Administration.

And thank you, Mr. Chairman, for your leadership in moving this issue very quickly at the beginning of the new session, because of its importance to so many of our workers in need of the additional assistance and guidance. And if I could, Mr. Chairman, I would also add my words of gratitude for your service to our Nation and to all men and women who have served our nation and who have overcome such challenges as you have done. I'm proud to be a new Member of the Subcommittee with you. Thank you.

Chairman Johnson. I appreciate that. Thank you.

Mr. Wu, do you care to comment?

Mr. Wu. Thank you very much, Mr. Chairman.

I would like to ask the Assistant Secretary a question or two about the vesting aspects, or what I view as vesting aspects, of the bill that passed through our Subcommittee and the Full Committee and the House last year. And I come at this from the perspective of someone who has run, if you will, in essence, a small business.

I had thought that it would be wise to have a vesting period for our retirement plan, and it was one of my Republican law partners who actually said: If folks are sticking around just to vest, that is the worst reason for someone to stick around. You know, you want someone on your team

who is pulling hard on the harness all the time and not just for compensation or pension reasons. And I acceded to his wisdom in that particular instance.

In the bill that we passed, we have a rolling 3-year period. And as I recall, I supported that bill, but with reservations about that particular provision. We have some pretty significant businesses in Oregon, which provide instant vesting, and you can opt out of the employer stock the moment that you receive it. I have heard the arguments about employers not being interested in providing stock if employees would just leave it.

Do you think that that is a real issue, or is that a bit of a canard? And if it is more than a canard, what percentage of employers do you think would fail to offer their employees their own stock because of faster vesting provisions?

Ms. Combs. I do think it is a real issue. I don't have any statistics to say what percentage of employers would stop offering stock or, more importantly, stop offering matching contributions. And you are right, many plans do allow immediate diversification out of employer stock and they find that that works well for their workforce and it meets their objectives. But other employers have said that if they can't keep the employer stock to give people some connection for three years or so with participation, that they won't be able to make as generous a matching contribution because they won't use stock to match.

Mr. Wu. What drives that concern? Because if I were an employer, I would think boy, I want my employees to keep my stock because they want to, not because they have to. And if there is a "have to" aspect of this, then there are other aspects of my business plan that I ought to be looking at. Don't you think that if your own employees want to opt out real fast, the business has a bit of a problem?

Ms. Combs. I think some employers want to build loyalty. They are giving the stock as a way to reward people who are going to stay with them for a while. They view it as a reward and, therefore, they want to have some time restraints on it. I think there are different business models and different motivations for companies. But we heard from many, many employers that said it was important that there be a period of time in which they could require that the match in contributions primarily remain invested in employer securities.

It is cost effective for companies to make matches in employer securities, and so they want to keep it in stock and they want to have some of it invested because they think it builds employee loyalty to the firm to be an owner/investor as well as an employee, and I think it does.

Mr. Wu. Well, I have been supportive of various aspects of what I hope to be a bipartisan bill, but I do have to say that I have deep concerns about an employer that can't earn that loyalty on a day-by-day basis.

Ms. Combs. The bill doesn't require you to keep it for 3-years. That is the maximum you can keep it. You can still have a plan where the stock could be sold the next day. It is just saying that those companies under the current law that say you can't sell until you are age fifty or you can't sell until you retire can't restrict it any longer than 3-years.

Mr. Wu. I understand the provisions of the bill. There is a competing 1-year provision, and I am proposing that; you know, 1-year is pretty long. You know, if you are running your business well and you are treating your employees well, then hopefully, even if they can flip out on day one, they will stick with you. And a lot of people do stay out of feelings of loyalty and sometimes out of inertia. So I am rather concerned about this 3-year period.

Chairman Johnson. The gentleman's time has expired.

Mr. Wu. Thank you, Mr. Chairman.

Chairman Johnson. That is fine. Let me just explain to you again what she said. It is voluntary on the company's part. It is the companies that require their employees to hold the stock for 40 years as an example, or until employees reach age 55 that we were getting at. The companies that have employees that want to turn their stock over on the first day can.

Mr. Wu. Yes, Mr. Chairman. I understand that we are trying to level the playing field, if you will. But it is a question of how level we are going to make it; a little bit smoother or a little bit rougher. And a 3-year roughness is, from my perspective, too rough.

Chairman Johnson. I know you also understand the idea of compromise up here in order to get something done.

Mr. Wu. I surely do. And I think 1-year is a wonderful compromise.

Chairman Johnson. Ms. Combs, thank you so much for your time and valuable testimony. We appreciate the job you are doing. What is the acronym again for the new name of the agency?

Ms. Combs. The acronym is EBSA, for Employee Benefits Security Administration.

Chairman Johnson. Thank you so much for being here. We appreciate your time, and you may step down.

Ms. Combs. Thank you.

Chairman Johnson. I would ask that the second panel come forward and take their seats. Thank you so much.

For the benefit of the witnesses and the Members who are still here, we are expecting one vote within 5 minutes or so. We will recess at that point until the vote is over and come back and begin where we left off. We will do what we can right now.

Our first witness on the second panel is Mr. Ed Rosic. He is Vice President and Managing Assistant General Counsel for Marriott International, Inc., Bethesda, MD. Mr. Rosic is testifying on behalf of the American Benefits Council.

The second witness is Ms. Nell Minow. Ms. Minow is the Editor for The Corporate Library, Portland, ME.

And the final witness for today is Mr. Scott Sleyster. Mr. Sleyster is the Senior Vice President and President of Retirement Services and Guaranteed Products for Prudential Financial, Washington, D.C.

I ask you all to limit your statements to 5-minutes, if you will. Your written statements will be included in the record. And I remind Members that the same 5-minute rule for questioning witnesses applies.

Mr. Rosic, you may begin your testimony now. And if we quit in the middle in a minute, we will start where we left off. Go ahead, please, sir.

STATEMENT OF ED ROSIC, VICE PRESIDENT AND MANAGING ASSISTANT GENERAL COUNSEL, MARRIOTT INTERNATIONAL, INC., BETHESDA, MD, TESTIFYING ON BEHALF OF AMERICAN BENEFITS COUNCIL

Good afternoon, Chairman Johnson, Ranking Member Andrews, and Members of the Subcommittee. Thank you for the opportunity to appear this afternoon. As you noted, I am Ed Rosic with Marriott International. We are headquartered in Bethesda, Maryland.

With over 144,000 employees and nearly 2,600 operating units, Marriott is a leading worldwide operator and franchiser of hotels and related lodging facilities. I am here this afternoon on behalf of the American Benefits Council, which is a public policy organization principally representing Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either directly sponsor or provide services to retirement stock and health plans covering more than 100 million Americans.

Let me begin by noting the importance of our voluntary employer-sponsored retirement savings system. Today, more than 56 million workers have amassed more than $2 trillion in retirement savings, and many have built a substantial ownership stake in their company. These successful employer-sponsored plans not only prepare workers for retirement and democratize corporate ownership, but they also serve as engines of economic growth.

Chairman Johnson, you understand the delicate balance of regulation and incentives upon which the success of this voluntary employer-sponsored pension system depends, and we appreciate your sensitivity to these issues as you lead this Subcommittee's approach on retirement policy.

In order to avoid unintended harms, the Council believes that retirement savings policies should focus on insuring that 401(k) participants have the information, education, and professional

advice they need to wisely exercise their investment responsibility. We supported the proposals contained in the Pension Security Act of 2002 that would have helped employers facilitate professional investment advice for 401(k) participants. The employees at Marriott are provided with an array of educational services for retirement planning; however, Marriott, along with many other employers, would welcome the additional flexibility in choices provided by these investment advice provisions.

Moreover, the Council would urge the inclusion of tax incentives for qualified retirement planning services, and we, likewise, support providing employees with more regular retirement plan benefit statements that stress the importance of diversification.

In addressing the question of company stock and retirement plans, we have been concerned that aggressive diversification rules could risk reduced matching contributions in some circumstances since employers would no longer be able to guarantee that every worker has a long-term ownership stake. The Pension Security Act's diversification rule, under which employees can exchange shares of company stock after three years, is directly responsive to our concern. It allows employers to use either 3-years of service rule, or a rolling 3-years from date of grant rule, and also adopts a transition rule under the proposed diversification regime. We sincerely appreciated the bill's approach on this issue.

Finally, we wish to thank you and Chairman Boehner for rejecting more onerous mandates and liabilities such as expanded ERISA liability, joint trusteeship, and additional fiduciary insurance, all of which would unfairly penalize broad-based employee ownership. And we would urge your continued opposition to such proposals.

The Council would support including in the reintroduced Pension Security Act several other initiatives that were dropped from the 2001 tax reform bill and that would enhance the voluntary employer-sponsored retirement system. These provisions include expansion of the employee plans compliance resolution system, the missing participants program, and the incentives for forming new defined benefit plans. Recently there has been renewed interest in defined benefit pension plans due to their guaranteed nature and the important buffer they provide to employees against market risk. We believe Congress should also use the occasion of its review of the defined contribution plan system to streamline the rules that apply to defined benefit plans so more companies can provide these employer-funded and insured plans to workers.

Chairman Johnson, you have led the way in addressing one of the most vexing problems faced today by defined benefit plan sponsors: The inflated liabilities, the funding requirements, and premium obligations that have resulted from the buy-back and discontinuation of the 30-year Treasury bond. We are pleased that you have expressed your desire to enact permanent pension interest rate reform.

Chairman Johnson, the Council also commends you for supporting broad-based stock ownership and enhancing the opportunities for equity ownership by rank and file employees. We fully support legislation that excludes statutory stock option plans, such as employee stock purchase plans, from the imposition of federal payroll tax withholding.

In closing, Mr. Chairman, the Council urges a cautious and prudent retirement policy approach so as not to undermine our successful retirement savings and employee ownership system. Thank you for the opportunity to appear.

WRITTEN STATEMENT OF ED ROSIC, VICE PRESIDENT AND MANAGING ASSISTANT GENERAL COUNSEL, MARRIOTT INTERNATIONAL, INC., BETHESDA, MD, TESTIFYING ON BEHALF OF AMERICAN BENEFITS COUNCIL – SEE APPENDIX C

Chairman Johnson. Thank you, sir. I appreciate all of you being here, and your time. It is not easy for you to come up here sometimes. But right now we have got a vote call. We will recess and be back as soon as this vote is over, somewhere around 15 minutes. The committee stands in recess.

[Recess.]

Chairman Johnson. The Subcommittee will come to order. We will be back in session, and begin the testimony with Mrs. Minow. Please go ahead with your testimony now. Thank you for being here.

Ms. Minow. Thank you very much, Mr. Chairman. It is a great honor to be here, and I appreciate your allowing me to substitute for my long-time colleague Bob Monks. I ask to submit his testimony into the record.

Bob Monks, of course, was at one time the head of what we used to call PWBA and is very familiar with these issues.

Chairman Johnson. What is it called now?

Mr. Andrews. EBSA.

Ms. Minow. EBSA. Thank you, Mr. Andrews. I forgot it already.

STATEMENT OF NELL MINOW, EDITOR, THE CORPORATE LIBRARY, PORTLAND, ME

I am here really to talk about just one of the issues that has come up with regard to the proposed legislation, and to tell you that in general I am very supportive of the leadership that you are showing on these issues and of the bill. But I do want to raise some concerns over the issue of conflicts of interest that may arise, and to encourage you to continue to keep the barriers to recommendation of products that can create that conflict of interest.

I think if the year 2002 taught us anything about the vulnerabilities in our system, it is that we do have to take conflicts of interest very, very seriously. Particularly, the conflicts have been exacerbated with the elimination of many of the restraints on conglomeration. The conflicts are there. They are real. They exist. And it seems ironic to me that in an era where we are working so hard to strengthen Chinese walls and barriers to conflicts in so much of our financial markets, we are talking about removing some of those protections in this very sensitive area.

Right now, the trustee is prohibited from making investment advisory arrangements and for making recommendations for services that are that advisor's own services. And there is no reason to remove that protection. There are similar services available in many, many different places. And I am not at all persuaded that a disclaimer or a disclosure of conflict of interest will correct the problem. I think we have had a tradition in our regulatory system of making distinctions between different kinds of investors. We allow sophisticated and wealthy investors, for example, to do things that we don't allow the average American to do. And we are talking about average Americans here.

I have great respect for their intelligence and their integrity, but I do think they get overwhelmed with some of this financial information. And when you talk about setting up these special relationships, you talk about how they do want to talk to a person, they want to have some human interaction, and they become very vulnerable at that same point. And when that same person they are talking to says, listen, I think my own products are the best; now, there is a conflict, I am warning you about that, but you still want to buy my own products. I think you are really opening up the door to an area of abuse that is completely unnecessary.

Those that propose the amendment say that the Pension Security Act would fix outdated Federal laws and allow employers to provide their workers with high quality professional investment as an employee benefit, but also include key safeguards to protect the interests of the workers. It must be a commentary on the times in which we live that restriction against conflict of interest can be characterized as outdated Federal laws. I think conflicts of interest are very serious.

I want to put that into context for a moment and say that while I respect Secretary Combs' comments about the ability of the Department of Labor to enforce conflict of interest issues, frankly, they failed very badly over the years with regard to conflicts. None of the abuses of the corporate meltdowns of last year would have been possible without the complicit support of the large pension funds in endorsing incompetent boards of directors, outrageous pay plans, et cetera. And yet the Labor Department has never once, ever, ever brought an action against a pension fund for failure of fiduciary obligation and protecting them on those issues.

The GAO has just undertaken an investigation in that area for the first time, I am pleased to say, on the issue that has been written up in the current issue of Business Week on Deutsch Asset management at Hewlett-Packard/Compaq. I would at least wait until you get that kind of data before you consider repealing this important protection. Thank you very much.

Chairman Johnson. Thank you, ma'am, we appreciate your testimony.

Mr. Sleyster, would you go ahead with your testimony now.

STATEMENT OF SCOTT SLEYSTER, SENIOR VICE PRESIDENT AND PRESIDENT OF RETIREMENT SERVICES AND GUARANTEED PRODUCTS, PRUDENTIAL FINANCIAL, FLORHAM PARK, NJ

Good afternoon, Chairman Johnson, Ranking Member Andrews, and Members of the Subcommittee. Thank you for the opportunity to appear this afternoon to testify about the need for investment advice for participants in defined contribution retirement plans and the safety and soundness associated with the provisions contained in the Pension Security Act. I am Scott Sleyster, President of Prudential Retirement Services and Guaranteed Products, a business of Prudential Financial. Prudential has over 75 years of experience serving the retirement needs of public, private, and nonprofit organizations. We manage or administer more than $60 billion of retirement assets, and we provide defined contribution services to one million participants, and annuity payments to 600,000 defined benefit participants.

Mr. Chairman, as you and Chairman Boehner recognized by your sponsorship of the Pension Security Act, Federal pension law needs to be amended and modernized to encourage employers to provide workers with access to professional investment advice. When ERISA was passed in 1974, defined benefit plans (DB) were the primary platform upon which retirement benefits were being delivered, and the legislation was focused on the DB system.

Today, defined contribution plans (DC) dominate the retirement landscape with over 40 million workers relying on DC plans for all or part of their non Social Security retirement income. As you know, DC plans have shifted all that investment risk to the workers. In the D B plans, the employer retained that investment risk and they typically hired actuarial and investment firms to study funding requirements and make their investment decisions. In DC plans, we have typically shifted that responsibility to the individuals to make on their own, and the workers who have to make those decisions are seeking advice.

Prudential recently conducted a survey that confirmed that participants are seeking guidance in managing their DC accounts. Among our survey's notable findings were that almost 60 percent of American workers feel that they are not saving enough for retirement. Only half of all the respondents set any type of savings goal, and upon further questioning, 30 percent of those who said they did set a goal said they did so by guessing. This finding is consistent with the 2002 retirement confidence survey that indicated that fewer than one third of workers surveyed have calculated how much money they need to save by the time they retire.

Many workers are eligible but do not participate in their DC plans. Of these, 68 percent do not have college degrees, 45 percent have less than $50,000 in annual income, and 54 percent of them have children. Defined contribution participants indicate that they would like to get financial advice through their plan to help them better manage their investment decisions. Sixty three percent of participants surveyed responded that if they had access to a professional investment

advisor, they would increase their savings level, and 41 percent said they would reallocate their portfolios based on this advice.

Mr. Chairman, we at Prudential are committed to finding effective and efficient ways to provide DC plan participants with advice. While some have expressed concerns about fund providers offering advice, there are several reasons why fund providers are actually very well positioned to offer advice to the plans that they administer. Furthermore, the legislation does include substantial protections to ensure that participants are protected from conflicts of interest.

I think the most important reason, Mr. Chairman, is the efficient and effective delivery of this advice. Plan record keepers who currently offer investment funds already have access to the plan rules and knowledge of the plan's investment options. They are aware of the payroll contribution records of each participant. And the delivery of the investment advice, in effect, would be very low cost because it is just a simple extension of the services that are already being provided, and it would be provided in the format that the participants are already familiar dealing with; the 1-800 number and over the Internet.

Also, the DC market is intensely competitive, and there would be significant pressure for advisors to provide the best possible advice. Employers have an extensive universe of record keepers and investment advisors available to choose from, and ample opportunities to replace any advisor not performing at the highest level. Additionally, you have two layers of protection. The plan sponsor is already screening the choices that are available in DC plans and they are reviewing which choices are available. So it is a limited universe. And then, of course, as you know, the advice being offered would be subject to fiduciary rules.

In summary, Mr. Chairman, if the legislative goal is to help as many qualified plan participants as possible gain access to high quality professional investment advice, I believe the overall solution must include the ability for fund providers to offer advice. Fund providers serving as record keepers are in the best position to provide investment advice in a low cost, effective manner. If we do not find a more effective way to allow DC plan participants to access professional investment advice, I believe that we will not have done enough to make real progress towards Americans achieving retirement security. Thank you for the opportunity to speak today.

WRITTEN STATEMENT OF SCOTT SLEYSTER, SENIOR VICE PRESIDENT AND PRESIDENT OF RETIREMENT SERVICES AND GUARANTEED PRODUCTS, PRUDENTIAL FINANCIAL, FLORHAM PARK, NJ – SEE APPENDIX D

Chairman Johnson. Thank you, and thank you to all three of you.

I am going to do something a little different here. Ms. Minow talked about security and the thought that whomever the advisor might be is subject to some, I don't want to call it fraud, but “mis-advice”, shall we say, because he is going to push his own product.

One at a time, I would like you three to tell me what you think of that, and why there isn't enough protection in this bill. The person doing the advising has got to be under severe regulations from almost every source. He has got to pass a lot of tests in order to be an advisor. And in your case, he is part of a big company that is not going to let him do something that is not right. Furthermore, he could lose his license and ability to have a means of support if he did advise in the wrong way.

So, can you comment on that first, Ms. Minow? And then I would like to hear you two respond.

Ms. Minow. Yes, Mr. Chairman. Thank you.

Let me put it this way: There are a wide range of financial products out there which are, with all respect to Prudential, almost identical. So what is the benefit? We have to ask ourselves what is the benefit of allowing them to present their own products, and what is the cost of allowing them to present their own products.

The fact is, because they are so similar, they will have a natural inclination to want to promote the ones that have the greater return for them. And with respect, I have to disagree that there are significant disincentives to do that.

The Labor Department's history of enforcing conflict of interest concerns, as I said, is almost nonexistent. Furthermore, the rules themselves are kind of squishy. As long as they recommend a product that somebody else has bought into, it is going to be very hard to prove that it is fraudulent.

I am not talking about fraud. I think we are okay, that fraud is taken care of. I am talking about a conflict of interest where the advisor is going to protect his own interests as well as the person he is advising, and I think we should take that out of the equation.

Chairman Johnson. Well, the conflict normally arises, at least it has been stated as such in our other hearings, from advisors telling them they need to buy the company's stock.

Ms. Minow. Certainly.

Chairman Johnson. And of course if Prudential has, and we will use them because they are here and they can defend themselves, their own line of products, you are, in essence, saying that is the company stock; is that true?

Ms. Minow. Yes.

Chairman Johnson. That is what you are trying to say?

Ms. Minow. That creates the same kind of conflict. In other words, certainly they would have an incentive to promote the stock of the person who is employing them because they want to make them happy. Then they would want to make themselves happy. But an index fund is an index fund

is an index fund. And, frankly, we are talking about retirement funds. We are not going to be telling them to invest in hydroponic futures; we are going to be talking just standard products.

Chairman Johnson. I hope not.

Would you respond, please?

Mr. Sleyster. Well, I have a couple of comments.

I think, first and foremost, you need to remember that the choices or options that are being offered in DC plans have already been reviewed by the plan sponsor. The industry has demanded open architecture for some time. So you typically have 11 to 15 choices, and in most cases, our funds and any company's funds would probably only represent about a third of that.

Second, the most important decision here isn't the individual fund or even fund manager. The most important issue in managing a portfolio is asset allocation. And models are built to design asset allocation, and that is really what designs the choices you have. So, that if you have 15 funds, you don't have 15 growth funds; you have some that are growth, some that are international, some that are small capped, some that are fixed income, some that are stable value. So many times with what the model is kicking out, you may or may not even have a proprietary asset choice there. And I think what really drives this is asset allocation.

The third point I would make, and I think it is probably the most important, is that the issue here is how are we going to get advice to people in a cost effective manner. While you can probably come up with more esoteric and elegant solutions that seem pure, if you are asking the company to fund that or you are asking the participant to pay an additional fee for that, then you are going to end up with what we have ended up with already, which is tools out there that aren't utilized or options that plan sponsors don't want to pay for.

And, you know, quite frankly, that is really the issue: How do we get investment advice to the average employee? Remember, in the average 401(k) balance in America, 45 percent of plan participants have less than $10,000. People aren't typically trying to go after those customers to sell them other products. The real question is, how do we get them advice that is as close to unbiased as possible, but also in a very cost efficient and simple manner.

Chairman Johnson. And you feel that they are protected because of the laws that are already in place in the investment industry?

Mr. Sleyster. Well, as a participant in the industry, I can only say we feel very fully regulated. We have very strong internal controls, but we also are audited, quite frankly, every time we set up a plan. The plan sponsor comes out and looks at what we do. And then we are also audited as a broker dealer and a licensed security.

Chairman Johnson. Arthur Andersen put you all on alert, didn't it?

Mr. Sleyster. Well, we feel that we are under a very bright spotlight.

Chairman Johnson. Thank you.

Do you have a comment?

Mr. Rosic. I tend to agree with Mr. Sleyster. We are talking about some fundamental advice here. And while I understand the practical concerns that Ms. Minow has, we do have the fundamental protections of ERISA still in place, plus the other legal regulatory environments for these advisors. The plan sponsor and the other fiduciaries of the plan are still players. And that is what ERISA's setup structure is about, to provide the basic protections. There is an enforcement issue, not just with the government, but there are private enforcement mechanisms available as well.

Chairman Johnson. Thank you.

Mr. Andrews, you are recognized for 5 minutes.

Mr. Andrews. Thank you.

First of all, I would like to thank the panel for the excellent thought-provoking testimony. I have had a chance to read all the statements, and I appreciate it.

Here is the practical situation I am concerned about, and I would ask each of the three panelists to comment. We had a comment a minute ago that 45 percent of the participants in 401(k) plans have less than $10,000. Here is the problem. One of those persons with a small 401(k) gets conflicted investment advice that turns out to be a violation of fiduciary duty. The investment advisor says, you know, the right thing for you to do is to put all of your money into this one fund. And it turns out that it is a poor asset allocation decision, and the person suffers a $6,000 loss in her $10,000 401(k).

I know that this is a violation of ERISA's breach of fiduciary duty. I also know that as a practical matter the history of this statute tells us that absolutely nothing is going to happen as a result to benefit the person who just lost 60 percent of her 401(k).

Let us review the possibilities she has under present law. The first is that she could sue, I suppose, the planned trustee or someone in the chain of fiduciary control for breach of fiduciary duty. Given the realities of contingent fee practice, she is not going to find a lawyer who is going to represent her in a case where her maximum recovery is $6,000. It is not going to happen.

The second reality that she has is she could write to the Department of Labor and ask them to do something about it. You all were present in the room earlier when the Assistant Secretary was here and told us that in the largest pension scandal in the modern history of the country, it has taken more than a year to do anything about that. So I think the prospects of them doing something for a $6,000 claim are rather slender.

I would ask the panel two questions, and I sincerely mean this. Number one, what is wrong with my conclusions about the remedial realities? Am I missing something? And number two, if those remedial deficiencies do exist, of what value is the protection of ERISA fiduciary coverage for someone who receives conflicted advice, a breach of fiduciary duty? Any of the three of you may start.

Mr. Rosic. I think that a third remedy that might be available is monitoring by the plan sponsor and the other plan fiduciaries. This is going to act as a discouragement to a financial advisor for the kind of behavior you are speaking about. I know, for example, at my company if we retain a service provider who fails to measure up to the performance standards we specify, we send out an RFP (Request For Proposal) and hire somebody new. I think that might be significant since this is a business driven by small margins in many respects, and I think that is a significant, potential check on that kind of breach of fiduciary responsibility.

Mr. Andrews. How often have one of the maids who work at a Marriott property forced you to change, or induced you to change pension plan carriers? Has that ever happened?

Mr. Rosic. Well, we have a thorough system for vetting the service providers and the investment managers, et cetera. And we do listen to our associates who express displeasure or desire for new investment options, things like that. We grew from six to 13 investment options by reason of requests for mutual funds and index choices and things like that. So we do listen to our people. Whether there has been a specific complaint, I don't know.

Mr. Andrews. I will say for the record, by the way, that I have had the most outstanding customer service at Marriott facilities I have ever had anywhere. I say that for the record. You folks do a great job. But I wonder if the folks who clean the rooms have that much influence over your selection of pension fiduciaries? Anybody else care to answer that one?

Ms. Minow. Yes.

Mr. Andrews, the next time Bob Monks can't be here to give his testimony, I am going to ask him to have you as a substitute, because you made the points that I was hoping to make far better and more sharply than I did. And I appreciate that very much.

That is exactly my point. It is one thing to talk about how much regulation there is and how much transparency there is, but the real fact is we have not had any enforcement in this area. And to open up a whole new area of vulnerability and conflicts of interest without any history of enforcement in the past I think is to invite in a lot more trouble.

Mr. Sleyster. If I could answer Congressman, I guess a point I would make is that although I am not an expert on enforcement of things at DOL, today without the benefit of investment advice, the average participant out there has most of their assets in two to three funds. So they are already over concentrated. And the advice that would be given would be from an asset allocation model that typically drives people into at least seven asset classes. So I would simply make the observation that we are really in the situation today that you described for a large proportion of our participants. And if we can't find a way to effectively get them advice, I think they are likely to remain in that

situation.

Mr. Andrews. I take it as a given that most of the industry would follow what I view as the example of Prudential, and give advice with integrity, which I think your company does. I am concerned, though, about regulating the minority of advisors that would not follow that practice of integrity. I don't think most of corporate America behaves like Enron, thank goodness for that. But Enron did behave like Enron. And the laws that should have been in place to protect the workers, who lost hundreds of millions of dollars of pension assets, perhaps billions, were insufficient. I don't want to expand that problem. Thank you very much to each of you.

Chairman Johnson. Mr. Tierney, do you care to question?

Mr. Tierney. Well, if Mr. Andrews hadn't done such a good job of driving home the points that I think are central to this issue, I might. But there is no sense of beating it any more than it has. And I think it is quite clear, and I have never heard anybody make a satisfactory explanation as to why we can't continue the protections that are in place. I don't think business is going to change one iota, and I think that we might do high fives if you run out of here and get change; but if you don't get that change, I think nothing will matter to anybody.

I hope that we would all have the sense to keep the protections there. And I would just close with that.

Chairman Johnson. Thank you, Mr. Tierney.

Mr. Sleyster, if employees do receive investment advice, what effect do you think it might have on company stock holdings?

Mr. Sleyster. Well, the most important point associated with that, Mr. Chairman, is that company stock, or, for that matter, any individual security does not represent an asset class and the fundamentals of diversification and building models for efficient frontiers rely on asset classes. So I believe what would happen is that people would have to specifically designate money that they didn't want to be part of their asset allocation pool. If it went into the asset allocation pool, an individual stock is a security, and not an asset class, and therefore, it typically would not get any weight.

Chairman Johnson. Thank you for that comment.

Mr. Rosic, your company, I think, has employee stock purchase plans, if I am not mistaken. Can you explain the benefit you have realized from your employees partly owning the company?

Mr. Rosic. Well, let me start by pointing out that in our 401(k) plan we have the Marriott company stock fund, which is completely voluntary. There are no contributions made directly into it. The entire fund is composed of money that participants have directed to that fund. Then in addition to the 401(k) plan we have an employee stock purchase plan under Section 423 of the Tax Code that is an additional opportunity for employees to participate in.

Chairman Johnson. The employee stock purchase plan is not your primary retirement plan; isn't that true?

Mr. Rosic. That is correct. Participation in the employee stock purchase plan is an extra benefit. The retirement plan is the 401(k) plan.

Chairman Johnson. Thank you, sir.

Mr. Andrews. Mr. Chairman, could I just add one other thing?

Chairman Johnson. Sure. Go ahead.

Mr. Andrews. This is a little bit off the topic, but one of our witnesses today also has expertise outside the field of securities, in the movie area. I happen to know Ms. Minow is an expert movie reviewer, and I hope she would enter for the record her forecast of the Academy Award winners for us. Am I correct that on your Web site, you do offer movie reviews?

Ms. Minow. It is a separate Web site, sir. It is MovieMom.com. Thank you very much. I am happy to put my predictions on the record. I think Jack Nicholson is going to get best actor, and I think that best actress will be Nicole Kidman.

Mr. Andrews. The Chairman just expressed a different opinion about the movie. And you know, the Chairman is always right.

Ms. Minow. I am not making a value judgment. I am making a prediction. Nicole Kidman will get best actress and Chris Cooper will get best supporting actor. And I think I will leave the rest of them open.

Mr. Andrews. I sincerely want to thank each of the three panelists for their excellent contributions to this discussion. I thank the Chairman.

Chairman Johnson. It has been a good discussion.

I notice one of our Members has just arrived. Do you care to comment?

Mr. Cole. Thank you, Mr. Chairman. I do.

I apologize for not being here for all your testimony. I was meeting with some constituents just outside. I have a couple of quick questions, and directed to any of you, so everybody feel free to take a swing at the ball.

How widely is it known among the general public that the match portion by a business to a 401(k) is not a mandatory contribution and that it really is a decision that has been made by the business for its own purposes, obviously for the benefit of the employee to enhance their retirement, but also to encourage firm loyalty. Do you find that most people understand that this is not an automatic? Do you find that when we try to regulate it and limit it and sometimes get rather

onerous in our requirements, that we discourage companies from bestowing what is good upon their employees?

Mr. Rosic. Well, from my perspective, I think that while it may be understood that it is not mandatory, it has become an expectation as part of a standard package that there be some form of match. However, the variation in the magnitude of the match, even among large companies and small companies, is such that I think there is a healthy understanding that it is not a promise.

Mr. Sleyster. I have two points to make. One, I think you know that a couple of very major corporations eliminated their match this year, so for people at those firms it became very apparent that it was not mandatory. My anecdotal evidence would be that at the managerial levels, I think people do understand that it is voluntary. But as you get down to the non-managerial levels and on the shop floor, if you will, I think it is believed to be more of an entitlement or an understanding that it has always been there and it always will be there.

Mr. Cole. Let me ask you a further question if I may. Do you think it is very widely known? I have a small business and we have a 401(k) program with an employer match. We don't use our own stock because we are a privately held company, and that really doesn't make sense for anybody, employer or employee. But there is no match necessarily for the employer who is going to the cost of actually administering the program and is going beyond what the law requires in making a match available at all.

I would suggest to you, while it is expected in large companies, there are a lot of small companies in this country that still don't offer a match. And again, if you make it more onerous for them, they are going to be either less inclined to do so, or as most things when you regulate it, it will just simply disappear.

So, I just want to commend you for coming in today. Thank you very much. And Mr. Chairman, thank you for giving me the opportunity to belatedly ask a couple of questions. I really think this is a very important piece of legislation, and look forward to helping move it through the process.

Chairman Johnson. That is fine. You know, Mr. Andrews and I like to have the new guys ask questions. You did a good job. Thank you, Mr. Cole.

If there are no further questions, I want to thank the witnesses for their valuable time and testimony. I do think this was a good hearing. And if there is no further business, the Subcommittee stands adjourned.

Whereupon, at 3:07 p.m., the Subcommittee was adjourned.

APPENDIX A - WRITTEN OPENING STATEMENT OF CHAIRMAN SAM JOHNSON, SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS, COMMITTEE ON EDUCATION AND THE WORKFORCE

Opening Statement of Rep. Sam Johnson
Chairman, Subcommittee on Employer-Employee Relations
Hearing on
"The Pension Security Act: New Pension Protections to Safeguard the Retirement Savings of American Workers"

February 13, 2003

"Today it is my privilege to Chair the first hearing on the Pension Security Act. Protecting the retirement security of Americans remains a key priority for all of us, and with the new Congress, we have a real opportunity to send President Bush a comprehensive pension security bill he can sign into law.

"We should not have to wait for another corporate scandal before we empower workers with new protections that can help them enhance and protect their retirement security. We are committed to addressing the pension security of American workers. Workers must be fully protected and fully prepared with the tools they need to protect and enhance their retirement savings.

"The Pension Security Act will give millions of Americans new tools to help them better manage and expand their retirement savings.

"This proposal:

- gives workers new freedom to diversify contributions of company stock after holding it for three years in their 401(k) accounts;
- provides employees access to high quality, professional investment advice;
- allows workers to purchase retirement planning services with pre-tax dollars; and
- gives workers better information about their pension plans.

"The measure also includes a number of provisions to make it easier for small businesses to start and maintain pension plans and would further protect employees by ensuring that statutory stock options will not be subject to payroll taxes.

"Last year, the full Committee held three hearings over four days to examine the collapse of Enron and how to better protect pension participants. We heard testimony from Administration officials, pension experts, and employees. One theme that emerged was that people need more resources to effectively manage their retirements.

"Enron, like most companies, did not provide its employees with access to investment advice. The Pension Security Act would fix outdated federal laws to allow employers to provide their workers with high-quality, professional investment advice as an employee

benefit while making advice providers personally liable for any advice not provided in the employee's best interest.

"Millions of employees who have seen their 401(k) balances dwindle might have been able to preserve their retirement savings if they'd had access to a qualified adviser who would have warned them in advance that they needed to diversify.

"Besides providing investment advice to workers, the Act includes new important measures that give employees the freedom to diversify their portfolio and provide employees with a benefit statement.

"More important, the bill strikes a critical balance between providing retirement security for workers, providing privately held companies a source of capital, and providing worker ownership through ESOPs.

"Under the bill, employees may sell company stocks and diversify into other investment options after they have held company stock for no more than three years. In addition, it requires companies to give workers quarterly benefit statements that include information about accounts, including the value of their assets, their right to diversify, and the importance of maintaining a diversified portfolio.

"I am proud that we are moving forward with the Pension Security Act as a bipartisan measure and I am hopeful that we can continue to work with our Democrat friends to reach consensus on the pension reforms I have just outlined.

"Last year, the House acted quickly in the face of corporate scandals to protect American workers' retirement by passing this plan. Unfortunately, the Senate did not even consider it. With the makeup of the new Congress, I think the time for this bill has come!

"Today, the Subcommittee will hear from two panels of witnesses on the subject of pension reform. Today our first witness will be the Assistant Secretary of the newly renamed Employee Benefits Security Administration at the Department of Labor – Ann Combs.

"The second panel represents plan sponsors, service providers, and pension experts. Both panels have a vital interest in any pension legislation. We welcome their comments and promise to keep their views in mind as we address this important issue.

"The nation's employer-based pension system is essential to the security of American workers. We should move quickly to finish the good work we began last Congress and restore confidence in our pension system."

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APPENDIX B - WRITTEN STATEMENT OF THE HONORABLE ANN L. COMBS, ASSISTANT SECRETARY, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, U.S. DEPARTMENT OF LABOR, WASHINGTON, D.C.

Testimony of the Hon. Ann Combs
Assistant Secretary of the Employee Benefits Security Administration

February 13, 2003

Introductory Remarks
Good afternoon Chairman Johnson, Ranking Member Andrews, and Members of the Subcommittee. Thank you for inviting me to discuss the Bush Administration's proposals to strengthen the retirement security of American workers, retirees and their families. I am proud to represent the Department of Labor and the Employee Benefits Security Administration (EBSA) (formerly the Pension and Welfare Benefits Administration), who work hard to protect the interests of plan participants and support the growth of our private pension and health benefits system.

As you may know, Labor Secretary Elaine L. Chao changed our agency's name last week to make the agency's mission more recognizable to those we serve. Last year, our EBSA Benefits Advisors located throughout the country assisted over 184,000 American workers, retirees and their families with retirement and health issues. This assistance is critical to our agency's mission, as well as to the Americans who benefit from our responsive service.

EBSA not only served a record number of workers through participant assistance, but also achieved record monetary recoveries of $832 million through enforcement actions for plans and participants in both pension and welfare plans. EBSA's enforcement program deters and corrects violations of the law that impact the lives of more than 150 million people who depend on the financial security of retirement and health plans.

With the recent revelations of corporate and union malfeasance combined with the challenging economy, Americans have heightened concerns about our private pension system. The Bush Administration has a comprehensive agenda representing both short- and long-term reform proposals to improve and strengthen our retirement system.

Congress made a down payment on improving retirement security by passing a portion of the President's Retirement Security Plan last year. The Administration believes the first order of business should be to pass the remainder of the Plan, as reiterated in the President's 2004 budget sent to Congress last week. We are pleased that the Chairman has made this an immediate priority.

The President's Retirement Security Plan
The President's Retirement Security Plan will provide workers with greater confidence, choice and control over their retirement savings. The Plan would strengthen workers' ability to manage their retirement funds by giving them more freedom to diversify their investments, provide better information to workers through improved 401(k) and pension plan statements, and encourage employers to provide their employees with access to

professional investment advice.

Congress successfully passed two proposals originally set forth in the President's Retirement Security Plan with the enactment of the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act guarantees that workers will now receive notice 30 days prior to a pension plan blackout period, and the Department released the final regulations for this provision on January 24, 2003.

The Sarbanes-Oxley Act also prohibits corporate officers from selling their own company stock during blackout periods. Jurisdiction over the enforcement of this provision was given to the Securities and Exchange Commission (SEC). The Department and the SEC coordinated efforts to produce complementary, and to the extent possible, parallel rules implementing our respective provisions of the statute. And, I'm proud to say, we accomplished our objective of issuing final rules before the effective date of the Act on January 26, 2003.

Improved Choice through Diversification
The President's Plan would increase workers' ability to diversify their retirement savings. The Bush Administration believes employers should continue to have the option to use company stock to make matching contributions. It is important to encourage employers to make as generous a contribution to workers' 401(k) plans as possible. The use of employer stock allows companies to be more generous with their matching contributions.

Workers, however, should also have the right to choose how they want to invest their retirement savings. The President's Plan would ensure that workers could sell company stock and diversify into other investment options after three years of participation in the plan. A recent Hewitt survey found that 62 percent of companies already have or are contemplating easing employer stock restrictions. The Bush Administration is pleased that the private sector is already responding to the needs of the workforce, but wants to ensure that all workers enjoy broader choice in investment.

Most workers whose 401(k) plans are invested heavily in employer 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 most recent data available). 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.

The President's plan contains no arbitrary caps on the amount of company stock that a worker can hold. Such a cap has been opposed across the political spectrum. The chief policy advisor of the AFL-CIO said, "Our people just value their ability to make their own personal decisions. They trust their own investment decisions more than they do anybody else's." The vast majority of American workers share these views.

Fortunately, a bipartisan consensus has emerged around the notion that increased and balanced diversification rights would improve our 401(k) system. We look forward to Congress passing legislation granting this important right to American workers.

Enhanced Information through Quarterly Benefit Statements
A meaningful ability to change investments also depends on workers receiving timely information about their 401(k) accounts. The President's Retirement Security Plan would require companies to provide workers with quarterly benefit statements with information about their accounts including the value of their assets, their rights to diversify, and the importance of maintaining a diversified portfolio.

The President's proposal explicitly allows the Secretary of Labor to tailor this requirement to the meet the needs of small businesses. With all plans, we must carefully maintain an appropriate balance when imposing mandatory notices and disclosures because their costs are borne directly by workers and retirees.

When combined with greater access to professional investment advice and greater freedom to diversify, we believe that quarterly, educational benefit statements will provide workers with the tools they need to make sound investment decisions.

Increased Confidence through Professional Investment Advice
As the pension and investment world has changed dramatically over the past 25 years, employers have increasingly empowered workers to manage their own retirement accounts. The number of participants in these plans has shifted away from traditional defined benefit pension plans and grown to 58 million as of 1998. Over four-fifths of all pension-covered workers are now enrolled in either a primary or supplemental defined contribution plan.

Individual Americans have primary responsibility for investing approximately $2 trillion in retirement savings through their defined contribution plans. Current ERISA law raises barriers against employers and investment firms providing individual investment advice to workers. As a result, millions of rank and file workers do not have the information and advice necessary to make sound investment decisions to enhance their long-term security and independence.

The President's Retirement Security Plan would increase workers' access to professional investment advice. By relying on expert advisers who assume full fiduciary responsibility for their counsel and disclose relationships and fees associated with investment alternatives, American workers will have the information to make better retirement decisions. The 401(k) service providers best understand their products, their plan sponsors, and their participants and will provide the greatest access to this essential advice service.

It's clear that people who participate in 401(k) plans want their employers and plans to provide more investment advice. According to a survey recently released by CIGNA Retirement and Investment Services, 89 percent of 401(k) investors want "specific information on investment decision-making."

Investment advice also encourages participation in employer-provided retirement plans. Studies conducted on behalf of the investment advisory firm mPower show workers who receive advice are more likely to participate in savings plans and to save more than workers who never get any guidance.

On December 14, 2001, the Department of Labor took a first step toward facilitating the broader availability of investment advice by issuing an advisory opinion (to SunAmerica) providing a model for independent investment advice. The model allows a financial services firm to provide advice services, including advice with respect to investment options offered by the firm, provided it hires an independent financial expert to make investment recommendations for their clients. Over the last year, several financial services companies have launched initiatives based on the advisory opinion, making independent investment advice more widely available to workers and their families.

The independent advice model of the advisory opinion, however, has limitations. For example, when a worker receives specific recommendations generated by the independent advisor and delivered by the financial service provider, the worker cannot consult with the financial services firm to question or deviate from those recommendations. A financial services firm cannot discuss its own products with a plan participant because of ERISA's prohibited transaction rules.

For many workers, investment decisions are intimidating. The Department is encouraged to see growing interest in the adoption of an alternative method sanctioned by the advisory opinion where workers turn over the decision making to the financial services firm who manages their account in accordance with the independent adviser's decisions.

Equally important, many employers continue to be uncertain about their liability for investment advice given to their workers by third parties. Legislation is needed to address the liability concerns of plan sponsors who are reluctant to make advice services available.

The investment advice proposal includes important safeguards to ensure that workers receive quality advice that is in their best interests. Only qualified "fiduciary advisers" that are fully regulated by applicable banking, insurance and securities laws would be able to provide investment advice. Investment advisers who breach their fiduciary duty would be personally liable for any failure to act solely in the interest of the worker, and would be subject to ERISA's civil and criminal penalties. It would be illegal for fiduciary advisers to make specific investment recommendations for the purpose of increasing their own compensation.

The House-passed bill keeps participants in control of their investment decisions by requiring that investment decisions be made exclusively by plan participants – not the fiduciary adviser. The adviser may make recommendations to participants, but may not make discretionary investment decisions on behalf of participants.

Advice providers also would have to clearly disclose any fees or potential conflicts, and make these disclosures when the advice is first given, at least annually thereafter, and whenever the worker requests it. Further, the advisers must disclose whenever their fees or affiliations materially change.

In sum, plan sponsors and their employees need more investment advice options. That is why the President strongly supports Chairman Boehner's legislation passed twice by the House of Representatives in the 107th Congress with strong bi-partisan margins. The bill

makes much-needed investment advice services more available to workers, while responding to the demands of employers who want to make these services available but are concerned about liability for advice given by a third party. We urge the Congress to move quickly and pass this legislation once and for all.

Synergies of Reform Proposals
The reforms set forth in the President's Retirement Security Plan complement each other. The need for investment advice will increase once workers are provided additional rights to diversify their retirement savings, as will the benefits of this advice. The President's Plan will give workers new freedom to sell company stock and diversify into other investment options after three years of participation in the plan. For workers with little or no investment sophistication, this new diversification right will be much more valuable when workers have access to professional investment advice to assist them in making these important decisions.

For example, the workers who may need to diversify the most, such as those Enron and WorldCom workers who held a high percentage of company stock in their accounts, could most benefit from access to professional investment advisers who could alert them to the benefits of diversification.

Taken together, the measures proposed by the President will give workers the choice, confidence and control they need to protect their savings and plan for a secure retirement future. Workers deserve the chance to make unrestricted investment decisions, the confidence that comes from good information and professional investment advice, and control over their retirement savings.

Conclusion
The Bush Administration is committed to working with Congress to ensure that the remaining reforms of the President's 2002 Retirement Security Plan – greater ability to diversify, improved disclosure and increased access to professional investment advice – are enacted into law. We support Chairmen Boehner and Johnson as they advance this critical legislation.

We must strengthen the confidence of the American workforce that their retirement savings are secure with these new pension protections, and look forward to working with Members of this Committee to achieve greater retirement security for all Americans.

APPENDIX C - WRITTEN STATEMENT OF ED ROSIC, VICE PRESIDENT AND MANAGING ASSISTANT GENERAL COUNSEL, MARRIOTT INTERNATIONAL, INC., BETHESDA, MD, TESTIFYING ON BEHALF OF AMERICAN BENEFITS COUNCIL

Testimony of Edward Rosic
Vice President and Managing Assistant General Counsel
Marriott International, Inc.

on behalf of the
American Benefits Council

Before the Subcommittee on Employer-Employee Relations
Committee on Education and the Workforce
United States House of Representatives
Washington, DC
February 13, 2003

Good morning, Chairman Johnson, Chairman Boehner, Ranking Member Andrews and members of the Subcommittee, and thank you for the opportunity to appear this morning. I am Edward Rosic, Vice President and Managing Assistant General Counsel of Marriott International, Inc., headquartered in Bethesda, Maryland. Marriott is a leading worldwide operator and franchiser of hotels and related lodging facilities. Marriott employs over 144,000 people in more than 60 countries and is a world hospitality leader with nearly 2,600 operating units.

I am here this morning on behalf of the American Benefits Council, which is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement, stock and health plans covering more than 100 million Americans.

Our Nation's Retirement Savings and Employee Ownership System Is A Great Success.

Let me begin, Mr. Chairman, by sharing the Council's perspective on our nation's voluntary, employer-sponsored retirement savings system. Today more than 42 million Americans participate in 401(k) plans and 14 million more participate in profit-sharing and employee stock ownership plans (ESOPs). These 56 million workers have amassed more than $2 trillion in retirement savings and many have built a substantial ownership stake in their company. These successful employer-

sponsored plans not only prepare workers for retirement and democratize corporate ownership, but also serve as an engine of economic growth by providing one of our nation's most significant sources of investment capital. Congress has, over many decades, promoted these retirement savings and employee ownership plans through tax and other incentives,[1] with very positive results for tens of millions of American workers.

Workers at Marriott are among those enjoying these very positive results. The approximately 53,000 employees and retirees participating in our 401(k) plan have amassed more than $1.48 billion in retirement assets. While our 401(k) match is provided in cash, we make Marriott Class A Common Stock available as one or our plan's investment options.[2] Why? Because our employees, who want to share in the success of the company, have asked us to do so. Also, because Marriott believes that the opportunity to invest in the company creates a culture of ownership and accountability among employees that promotes productivity and employment stability. Other firms that provide for an employee ownership opportunity share these same positive outcomes.[3] At the same time, we at Marriott take the principle of

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[1] The first stock bonus plans were granted tax-exempt status by Congress under the Revenue Act of 1921. See Robert W. Smiley, Jr. and Gregory K. Brown, "Employee Stock Ownership Plans (ESOPs)," *Handbook of Employee Benefits*, 5th ed., Jerry S. Rosenbloom, ed. (Homewood, Illinois: Dow Jones-Irwin, 2001).

[2] Today, employees have chosen to allocate approximately 14.8% of their total assets to the Marriott Company Stock Fund.

[3] A survey of academic literature demonstrates that improvements in organizational commitment, productivity and employment stability are common among firms that provide for an employee ownership opportunity. See Douglas Kruse, Testimony Before the Employer-Employee Relations Subcommittee, House Education and the Workforce Committee, February 13, 2002.

diversification very seriously, making it a prime focus of our communications to 401(k) participants. The Marriott 401(k) plan offers a total of 13 investment choices, of which company stock is but one.

For the same reasons described above, Marriott also maintains an employee stock purchase plan (ESPP), under which employees may voluntarily purchase Marriott stock at a discount. Approximately 9,000 of our workforce participate in the ESPP.

Last year, this Committee and the House of Representatives passed significant reforms that addressed several retirement policy issues in response to the Enron bankruptcy, including the issue of company stock in retirement plans. This year, as Congress again takes up these issues and evaluates the appropriate retirement policy response to the economic downturn, the Council urges you to keep the employer-sponsored system's success squarely in mind and hold true to the long congressional support for our nation's voluntary retirement savings system.

We cannot help but note that this hearing is taking place shortly after the proposal by the Bush Administration on improving and simplifying retirement savings. We wish to applaud the Bush Administration for raising important issues and seeking to strengthen retirement income security for older Americans. While we welcome the budget submission's emphasis on retirement savings and simplification of our pension laws, we remain concerned that the proposals for Lifetime Savings Accounts

and Retirement Savings Accounts may come at the expense of the voluntary, employer-sponsored retirement plan system. American employers play a vital role in the success of the voluntary system. By purchasing retirement plan services with economies of scale, using efficient payroll deduction systems, furnishing financial education and advice, offering matching contributions and engaging in other practices, companies make retirement savings not just possible but also cost-effective, convenient and broadly available.

The Appropriate Response: Information, Education and Professional Advice. Mr. Chairman, one cannot examine the realities of the retirement savings system without concluding that overly aggressive legislative change could unintentionally harm the very people that Congress hopes to protect. Chairman Johnson, you and Chairman Boehner both understand the delicate balance of regulation and incentives upon which the success of our voluntary, employer-sponsored pension system depends, and we appreciate your sensitivity to these issues as you lead this Committee's approach on retirement policy.

In order to avoid unintended harms, the Council believes that retirement policy, particularly the response to the question of company stock in retirement plans, should focus on ensuring that 401(k) participants have the information, education and professional advice they need to exercise wisely their investment responsibility. Chairman Johnson, this is the course that you and Chairman Boehner have charted.

We support the proposals contained in your Pension Security Act of 2003 to provide employees with more regular retirement plan benefit statements that stress the importance of diversification.

The Council likewise supports the provisions that will help employers facilitate professional investment advice for 401(k) participants. We have supported Chairman Boehner's Retirement Security Advice Act since it was first introduced and believe it will help many more 401(k) plan participants get the professional investment advice they desire. The authors of the Employee Retirement Income Security Act (ERISA) never envisioned the truly explosive growth in our defined contribution system over the past two decades. ERISA must now be modernized to allow a broader array of providers into the advice marketplace. The employees at Marriott are provided with an array of educational services for retirement planning. However, Marriott along with many other employers would welcome the additional flexibility and choices provided by the bill's investment advice provisions. We are pleased that you and Chairman Boehner have again included it the Pension Security Act. The Council is also pleased that the Pension Security Act provides financial incentives for qualified retirement planning services. Your bill will ensure that meaningful investment advice is not just available but also affordable as well.

In addressing the question of company stock in retirement plans, the Pension Security Act strikes an appropriate balance among the concerns for employee

ownership, diversification of investments and employer flexibility. We have been concerned throughout the debate on company stock that aggressive diversification rules could risk reduced matching contributions in some circumstances since employers would no longer be able to guarantee that every worker has a long-term ownership stake. The Pension Security Act's diversification rule – under which employees can exchange shares of company stock after three years – is directly responsive to this concern. The Council sincerely appreciates the bill's flexibility, which allows employers to use either a three-years of service rule or a 'rolling' three years from date of grant rule. We also applaud the fact that you have recognized that a different approach is needed for stand-alone ESOPs. Maintenance of today's diversification rules for these ESOPs will ensure that these employee ownership arrangements can continue to serve their important purpose. The Council also appreciates the inclusion of a transition rule under the new diversification regime. This will prevent market instability and ensure that the price at which employees sell shares is not decreased by a glut of stock all reaching the market at the same time. Finally, we wish to thank you and Chairman Boehner for rejecting more onerous mandates, some of which are discussed below, that would unfairly penalize broad-based employee ownership.

The Council is also pleased that the Pension Security Act includes several initiatives that were dropped from the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). These provisions, the so-called 'Byrd droppings' after the Senate

Byrd rule, would make several enhancements to the voluntary, employer-sponsored retirement system. For example, the Pension Security Act would improve compliance by strengthening the Employee Plans Compliance Resolution System, expand the missing participant program in order to allow workers to hold onto hard-earned retirement savings, and encourage new defined benefit plan formation by small business. These and other provisions will make important improvements in retirement security.

Mandates Will Only Harm the Voluntary, Employer-Sponsored System. Despite your measured approach to defined contribution plan reform, there are others who would imprudently impose increased liability and burdensome mandates on employer-sponsored plans. These proposals provide little in the way of real benefits to participants but do imperil the continued sponsorship of retirement plans. Last year, several proposals for increased liability and mandates, some of which are described below, surfaced in the wake of the events surrounding Enron and WorldCom, and they may arise again in this year's debates over retirement savings. We continue to urge your ardent opposition to these proposals if they come up in Committee or on the floor of the House.

- **Expanded ERISA Liability on Corporate 'Insiders.'** The careful balance already present in ERISA's remedy and liability regime would be upset by imposing fiduciary liability on new parties or authorizing additional varieties of damages.

Even a provision limited to so-called corporate "insiders" (officers and directors) would invite nuisance litigation and expose both employers and these individual parties to substantial new costs, even when defending against claims with little merit. It also gives these key corporate decision-makers a strong incentive not to have a qualified retirement plan. Such a change is also unnecessary since ERISA already embraces a functional definition of fiduciary under which such insiders can be liable where they have actual control or discretion over a plan. At a minimum, imposition of such liability on insiders will make it more difficult to find capable people to serve in these capacities.

- **Mandatory Fiduciary Insurance**. We believe that imposition of significant new fiduciary insurance requirements on plans that contain employer stock is nothing more than an attempt to remove employer stock from these plans. The difficulty in even obtaining such coverage – and the cost of such coverage where it can be obtained – will drive many employers to remove company stock from their retirement plans. This will result in reduced employer contributions to employee accounts and will deny employees an important investment and ownership opportunity. For the employers that may be able to obtain such insurance, it will be a significant extra expense and will be a significant incentive for frivolous litigation.

- **Joint Trusteeship and Other Forms of Mandated Employee Representation.** Decisions regarding compensation and benefits have long been the province of employers. Yet the law also allows employers to involve employees in plan decision-making in a variety of ways and many plan sponsors have done so. Moreover, when an employer makes the decision to adopt a retirement plan, ERISA imposes a strict duty to operate such plan solely in participants' interests. Those who fail to adhere to these stringent obligations face a litany of legal penalties, including personal liability. Legal mandates for employee representation and participation will only politicize and make adversarial what should be dispassionate fiduciary judgments. Moreover, the selection of employee representatives would be a complicated, expensive and controversial process that would require a new federal bureaucracy to oversee.

We hope that you will keep the concerns we have raised in mind. Each of the proposals discussed above would impose significant new burdens and liabilities on employers that voluntarily sponsor defined contribution plans. Cumulatively, we believe these provisions could cause a number of plan sponsors to scale back or abandon their defined contribution plans and would prevent additional employers from adopting such plans.

Time for a Renewed Congressional Commitment to Defined Benefit Plans. Recently, there has been renewed interest in defined benefit pension plans due to their guaranteed nature and the important buffer they provide to employees against market risk. Defined benefit pension plans, which are funded by the employer and insured by the federal government, make an effective complement to a defined contribution program. Yet the number of these plans continues to decline from a high of 175,000 in 1983 to fewer than 50,000 today, with the decline partly attributable to overly onerous rules and their attendant costs and complexities. We believe Congress should use the occasion of its review of the defined contribution system to streamline the rules that apply to defined benefit pensions so that more companies can provide these employer-funded and insured benefits to their workers. As noted above, we thank you for including in the Pension Security Act the provisions dropped in the Senate from the 2001 tax relief act, many of which directly aid defined benefit plans.

Chairman Johnson, you have led the way in addressing one of the most vexing problems faced today by defined benefit plan sponsors – the inflated liabilities, funding requirements and premium obligations that have resulted from the buyback and discontinuation of the 30-year Treasury bond. As you know, rates on 30-year bonds have fallen to historic lows as these bonds have become scarcer. Yet our pension laws require the 30-year rate to be used to calculate pension plan liabilities. The result has been to artificially inflate these liabilities by 15 to 25 percent, forcing

many employers to make huge and unwarranted pension contributions in the midst of an economic downturn. You were instrumental, Mr. Chairman, in including short-term relief from these unwarranted obligations in the Job Creation and Worker Assistance Act of 2002, and we are pleased that you have expressed your desire to enact a permanent reform of the pension interest rate issue.

Recently, in letters submitted to you and Chairman Boehner, the Council outlined a set of principles that should guide legislative reform of the 30-year Treasury bond interest rate for pension calculations. The key principles are as follows:

- **Adopt a Comprehensive Solution.** It is imperative that permanent interest rate reform revises the rate for all pension calculations required by ERISA and the Internal Revenue Code (Code) that are currently dependent on the 30-year Treasury bond rate. This comprehensive replacement of the 30-year Treasury bond would affect not only pension funding and premium calculations but also calculations affecting the valuation of lump sums and maximum benefits payable from defined benefit pension plans.

- **Use a Consistent Rate.** It is important that the same new benchmark be used for all of the ERISA and Code pension calculations currently dependent on the 30-year Treasury bond. Use of differing interest rates for different pension calculations (particularly for funding and lump sum purposes) could create severe financial instability in plans.

- **Select a Benchmark that Tracks the Return on a Conservatively Invested Portfolio.** We recommend that the new benchmark track the returns expected on a pension plan portfolio conservatively invested in long-term corporate bonds. Such a benchmark is one that the Pension Benefit Guaranty Corporation could meet or exceed through its own investing in the event that it assumes the liabilities of the pension plan.

- **Use a Blend of Corporate Bond Indices as the New Benchmark.** The most effective way to track the return of a portfolio conservatively invested in corporate bonds is to select an actual corporate bond index as the replacement for the 30-year Treasury bond rate. To avoid dependence on a single bond index and to replicate the breadth of the long-term corporate bond market, we recommend that the substitute for the 30-year rate be a blend of several different leading corporate bond indices (giving the Treasury Department flexibility to modify the indices if necessary).

- **Use the New Rate for Lump Sums but Provide a Transition Period.** The current law requirement to use the very low 30-year Treasury bond rate to value lump sums artificially and substantially inflates the value of these payments. This inflationary effect has contributed to the large number of pension plan participants who take their benefits in lump sum rather than annuity form (The low 30-year Treasury bond rates have no inflationary effect on the value of plan annuities). This artificial encouragement of lump sums –

and artificial discouragement of annuities – is unsound retirement policy that discourages the use of a distribution option that protects against spousal poverty and outliving one's assets. Participants should be encouraged to select the plan distribution option that works best for them and their families and should not be given an artificial economic incentive to choose one over the other. That being said, the switch to the new interest rate should be phased in so that lump sum values are not changed precipitously for participants on the verge of retirement.

- **Preserve the Existing Interest Rate Averaging and Corridors.** Given the urgency of enacting a replacement benchmark for the 30-year Treasury bond (the short-term relief enacted last only lasts through 2003), we recommend that the existing interest rate averaging mechanisms and corridors generally be maintained. Such an approach – in which the new blended corporate bond index is plugged into the existing statutory structure as a replacement for the 30-year bond rate – is the simplest approach and will facilitate prompt enactment of permanent reform.

With enactment of this urgently needed reform, Congress can move quickly to shore up the defined benefit pension system, preventing additional employers from abandoning these guaranteed plans that effectively advance workers' retirement security.

Enhancing Broad-Based Stock Ownership

Chairman Johnson and Chairman Boehner, the Council also commends you both for supporting broad-based stock ownership and enhancing the opportunities for equity ownership by rank-and-file employees. Chairman Johnson, you have been a strong advocate for providing relief for stock option owners from the reach of the alternative minimum tax. We also fully support the legislation that excludes statutory stock option plans such as employee stock purchase plans (ESPPs) from the imposition of federal payroll tax withholding. If withholding were to be imposed, employees, particularly rank-and-file employees, are less likely to retain shares after exercise of ESPP options because they will have to sell the stock to cover the additional tax liability. This hinders employee wealth accumulation and frustrates the opportunity for long-term appreciation in share value. In addition, tax withholding would increase not just taxes but administrative costs as well as discourage employers from offering stock options to rank-and-file employees. We thank you for your commitment to enacting a provision clarifying the treatment of employee stock purchase plans under payroll tax withholding statutes.

Conclusion.

In closing, Mr. Chairman, the Council urges a cautious and prudent retirement policy response so as not to undermine our successful retirement savings and employee ownership system. We applaud you and Chairman Boehner for taking this course. Information and advice – rather than additional mandates and over-regulation – are

the strategies that will protect 401(k) participants while fostering the continued growth of the private, employer-sponsored defined contribution plan system. Finally, we appreciate your recognition that in order for employers to continue to offer employees a diverse set of benefit arrangements these 401(k) reforms must be accompanied by actions that support and expand defined benefit and stock ownership plans.

Thank you, Mr. Chairman, for the opportunity to appear today.

Committee on Education and the Workforce

Witness Disclosure Requirement – "Truth in Testimony"
Required by House Rule XI, Clause 2(g)

Your Name:		
1. Will you be representing a federal, State, or local government entity? (If the answer is yes please contact the Committee).	Yes	No X
2. Please list any federal grants or contracts (including subgrants or subcontracts) which you have received since October 1, 2000:		
3. Will you be representing an entity other than a government entity?	Yes X	No
4. Other than yourself, please list what entity or entities you will be representing: American Benefits Council		
5. Please list any offices or elected positions held and/or briefly describe your representational capacity with each of the entities you listed in response to question 4:		
6. Please list any federal grants or contracts (including subgrants or subcontracts) received by the entities you listed in response to question 4 since October 1, 1999, including the source and amount of each grant or contract:		
7. Are there parent organizations, subsidiaries, or partnerships to the entities you disclosed in response to question number 4 that you will not be representing? If so, please list:	Yes	No X

Signature: _____ Date: 2/10/2003

Please attach this sheet to your written testimony.

APPENDIX D - WRITTEN STATEMENT OF SCOTT SLEYSTER, SENIOR VICE PRESIDENT AND PRESIDENT OF RETIREMENT SERVICES AND GUARANTEED PRODUCTS, PRUDENTIAL FINANCIAL, FLORHAM PARK, NJ

Testimony of Scott Sleyster
President, Prudential Retirement Services and Guaranteed Products

Public Hearing on The Pension Security Act: New Pension Protections to Safeguard the Retirement Savings of American Workers

Before the Subcommittee on Employer-Employee Relations
Committee on Education and the Workforce
United States House of Representatives
Washington, DC
February 13, 2003

Good afternoon, Chairman Johnson, Ranking Member Andrews and members of the Subcommittee. Thank you for the opportunity to appear this afternoon to testify about the need for investment advice for participants in Defined Contribution retirement plans and the safety and soundness associated with the provisions contained in The Pension Security Act – an issue that could impact millions of retirement plan participants. I am Scott Sleyster, President of Prudential Retirement Services and Guaranteed Products, a business of Prudential Financial. Prudential has over 75 years of experience serving the retirement needs of public, private, and non-profit organizations. We manage or administer more than $60 billion of retirement assets and provide services to 1 million Defined Contribution participants and 600,000 Defined Benefit annuitants.

Participants Urgently Need Investment Advice

Let me begin, Mr. Chairman, by stating that as you and Chairman Boehner recognized in your sponsorship and reintroduction of The Pension Security Act, federal pension law needs to be amended and modernized to encourage employers to provide workers with access to professional investment advice. When ERISA was passed in 1974, Defined Benefit plans were the primary platform upon which retirement plans were being delivered and thus, the focus of legislation was based heavily on the Defined Benefit system. Today, Defined Contribution plans dominate the retirement landscape with over 40 million workers relying on Defined Contribution plans for all or part of their non-social security retirement income. As you know, Defined Contribution plans shift all the investment risk to workers. In Defined Benefit plans, the employer retains the investment risk and typically hires actuarial firms to establish funding requirements and test plan adequacy, and hires investment professionals to design appropriate asset allocation strategies and to make investment decisions. In Defined Contribution plans, participants are typically making these decisions on their own; clearly, these workers want and need access to advice.

This is evidenced in a survey[1] of participants that Prudential recently conducted. The survey found that the majority of workers are still a long way from a secure retirement, and that, because of poor goal-setting and a lack of savings, more than ever before, they need guidance and advice. Among the survey's notable findings are:

- 57% of American workers feel they are not saving as much as they should for their retirement. Among workers who are not enrolled in any employer-sponsored retirement plans, this figure rises to 73%.

- Few workers have established an informed retirement savings goal. Only 52% of all respondents have set any type of a goal, and barely 28% of those between 21

[1] *Employee Opinions on Retirement Plans: A Benchmark Study on Retirement Perceptions* polled 1,064 American workers in June 2002 to learn about their perceptions of employer-sponsored defined contribution plans and other issues critical to meeting their retirement goals. The study's participants are a national representative random sample of men and women aged 21 to 65 who have been with their current employers for at least a year and are eligible for the 401(k), 403(b) or 457 plans offered by their employers. The margin of error is plus or minus 3 percentage points at the 95% confidence level.

and 34 have a formal plan. In a very disappointing finding, upon follow-up questioning, we learned that 30% of those who indicated that they had established a goal indicated they did so by guessing. This is consistent with findings in The 2002 Retirement Confidence Survey[2] indicating that only 32% of workers surveyed have calculated how much money they will need to have saved by the time they retire.

- Many workers are eligible for employer-sponsored retirement plans but do not participate. Based on their demographic profile, these individuals might need the most help. Out of these non-participants, 68% do not have a college degree, 45% have less than $50,000 in annual income. Of these, 54% are married with children.

- Defined Contribution participants indicate that they would like to get financial advice through their plan to help them better manage their investment decisions. A strong majority (63%) of participants responded that if they had access to a professional investment advisor, they would increase their savings level, and 41% said they would reallocate their portfolio based on this advice. Personalized advice can also help non-participants gain the confidence they need to join employer-sponsored plans. In fact, 71% of non-participants indicated that personalized planning would influence their decision to participate in the plan.

Fund Providers Are Best Positioned To Offer Advice To The Plan Participants In Plans They Administer

Mr. Chairman, we at Prudential are committed to finding effective and efficient ways to provide investment advice to Defined Contribution plan participants. While some have expressed concern that advice from fund providers has the potential to be biased, there are several reasons why fund providers are actually best positioned to offer advice to the plans they administer. Furthermore, the legislation includes crucial protections that ensure that participants are protected from conflicts of interest. Here are the reasons:

- **Efficient and Effective Delivery:** Plan recordkeepers who currently offer investment funds already have access to, and knowledge of, plan investment options and rules, as well as payroll and contribution records for each participant. Delivery of investment advice could be done at a fairly low cost since it is only an extension of the services already provided to the plan.

- **ERISA Fiduciary Status:** Advisors would be required to acknowledge their status as fiduciaries and be subject to ERISA's fiduciary responsibility rules and prudence standard. ERISA requires fiduciaries to act in the best interest of participants and to be liable for any breach of their fiduciary duty. Simply put, under these rules it would be illegal for advisors to make specific investment

[2] *The 2002 Retirement Confidence Survey* was co-sponsored by the Employee Benefits Research Institute (EBRI), the American Savings Education Council (ASEC); and Mathew Greenwald & Associates, Inc. The survey polled 1,000 individuals (771 workers and 229 retirees) in the United States age 25 and older.

recommendations for the sole purpose of increasing their (or their firm's) compensation.

- **Marketplace Standards:** The Defined Contribution market is intensely competitive and would create significant pressure for advisors to provide the best possible advice. Inevitably, this will lead to benchmarking of performance, which will further safeguard participants' interests. Also, employers have an extensive universe of investment advisors to choose from and ample opportunities and choices to replace any advisors not performing at the highest level.

- **Monitoring by Plan Fiduciary:** Plan sponsors would continue to select the range of investment choices available to participants in their Defined Contribution plans. ERISA's fiduciary rules would continue to apply to the employer who selects the advisor. Thus, the employer would be required to act prudently and solely in the interest of participants in selecting and periodically monitoring the advisor to assure that advice was being provided in the best interest of participants. However, the bill does encourage employers to offer advice by making it clear that if they fulfill these duties, they will not be liable for the specific advice given by the advisor.

- **Fee and Limitation Disclosure:** Investment advisors would be required to disclose, in plain writing, to the employer and to participants: fees, the nature of the advisor's affiliation (if any) with the available investment options, and any limitations on the scope of the advice they provide.

- **Participant Control:** Participants would remain in control of their investment decisions. The bill requires that all investment decisions be made by the participant; not the advisor. The advisor would not have discretion to make investment decisions on behalf of participants.

- **Credentialed Advisors:** Advisors would be required to be appropriately credentialed and would be subject to regulations under other Federal or state securities, banking or insurance laws.

Conclusion

Mr. Chairman, if the legislative goal is to help as many qualified plan participants as possible gain access to high quality, professional investment advice, the overall solution must include the ability for fund providers to offer advice. Fund providers serving as recordkeepers are in the best position to provide investment advice in a low cost and effective manner. If we do not find a more effective way to allow Defined Contribution plan participants to access professional investment advice, we will not have done enough to help Americans make real progress toward achieving retirement security.

Thank you for your time and for inviting me to testify today.

Scott Sleyster, President
Prudential Retirement Services & Guaranteed Products

Scott Sleyster is responsible for the oversight of Prudential's Retirement Services and Guaranteed Products businesses. On a combined basis, Retirement Services and Guaranteed Products provide retirement products and services to nearly 1.6 million pension benefit plan participants and retirees. Collectively, these businesses manage over $60 billion in retirement plan assets in all markets including 401(k), 403(b), 457, Taft Hartley, and Defined Benefit Plans.

Scott and his staff have been active in supporting legislative efforts to promote the formation of new retirement plans, expand coverage under existing plans and increase the overall levels of retirement savings. Scott plans to continue this effort in connection with the next generation of pension reform proposals.

Scott is a member of the Employee Benefit Research Institute's (EBRI) Board of Trustees and the Corporate Executive Board's Retirement Services Roundtable.

Scott has an MBA in Finance from Northwestern University and graduated with distinction from the University of Missouri with a BSBA in Finance. He also holds the Chartered Financial Analyst (CFA) designation. Scott holds his NASD Series 7 and 24 designations.

2/2003

Committee on Education and the Workforce
Witness Disclosure Requirement – "Truth in Testimony"
Required by House Rule XI, Clause 2(g)

Your Name: Scott Sleyster		
1. Will you be representing a federal, State, or local government entity? (If the answer is yes, please contact the Committee.)	**Yes**	**No** X
2. Please list any federal grants or contracts (including subgrants or subcontracts) which you have received since October 1, 2000: **N/A**		
3. Will you be representing an entity other than a government entity?	**Yes** X	**No**
4. Other than yourself, please list what entity or entities you will be representing: **Prudential Financial, Inc.**		
5. Please list any offices or elected position held and/or briefly describe your representational capacity with each of the entities you listed in response to Question 4: **President, Prudential Retirement Services and Guaranteed Products**		
6. Please list any federal grants or contracts (including subgrants or subcontracts) received by the entities you listed in response to Question 4 since October 1, 1999, including the source and amount of each grant or contract: • **DOL/PBGC contracts effective November, 2000 – Please see attached.** • **Prudential Financial has other contracts with other federal government departments/agencies.**		
7. Are there parent organizations, subsidiaries, or partnerships to the entities you disclosed in response to Question 4 that you will not be representing? If so, please list:	**Yes**	**No** X

Signature: _____ Date: February 10, 2003

Please attach to your written testimony.

Page 2
Scott Sleyster
Truth in Testimony Form

PERSONAL INFORMATION: Please provide the committee with a copy of your resume (or a curriculum vitae). If none is available, please answer the following questions:

Biography on Mr. Sleyster is attached.

a. Please list any employment, occupation, or work related experiences, and education or training which relate to your qualifications to testify on or knowledge of the subject matter of the hearing:

b. Please provide any other information you wish to convey to the Committee which might aid the members of the Committee to understand better the context of your testimony.

Please attach to your written testimony.

Contract	Sub	Contractholder Name	Effective Date	State of Jurisdiction	12/31/2002 Statutory Reserves
000668	001	Pension Benefit Guaranty Corporation as Trustee of Lehigh Wholesale Grocery Company, Inc. Pension Plan	03/01/1958	PA	$1,020
000976	001	Pension Benefit Guaranty Corporation as Trustee of Eastern Rolling Mills, Inc. Local 13625 Pension Plan	08/07/1962	NY	$281,710
001451	001	Pension Benefit Guaranty Corporation, as Trustee of Munsingwear Vassarette Employees Pension Plan	10/01/1967	MN	$1,041
002450	001	Pension Benefit Guaranty Corporation, Trustee of Ryerson & Haynes Incorporated Salaried Employees Pension Trust	01/01/1972	MI	$14,272
004178	001	Pension Benefit Guaranty Corporation, Trustee of St. Clair Rubber Company Relirement Income Plan	11/01/1981	MI	$938,163
008961	001	Pension Benefit Guaranty Corporation as Trustee of the Crutcher Resources Corporation Retirement Plan	10/01/1984	TX	$5,163,446
009466	001	Pension Benefit Guaranty Corporation, as Trustee of the Garwood Industries, Inc. Findlay Division Hourly Rated Employees Pension Plan Agreement	12/01/1971	CA	$923
					$6,400,575

APPENDIX E – SUBMITTED FOR THE RECORD, ANSWER TO CASH BALANCE QUESTION POSED BY REP. CAROLYN McCARTHY

Answer to Cash Balance Question Posed by Rep. Carolyn McCarthy
February 13 Hearing
April 16, 2003

Question:

The Department has stated in the past that it is waiting for interpretative guidance from the Internal Revenue Service concerning issues that arise in the context of cash balance plans. Is the Department still awaiting this guidance?

Answer:

The Department has not received interpretative guidance from the Internal Revenue Service concerning issues arising in cash balance plans. EBSA last raised the issue with the Service on March 13, 2003.

APPENDIX F – SUBMITTED FOR THE RECORD, STATEMENT OF ROBERT A.G. MONKS, MECHANICSVILLE, MD

COMMITTEE ON EDUCATION AND THE WORKFORCE
U.S. House of Representatives

Subcommittee on Employer-Employee Relations
The Pension Security Act: New Pension protections to Safeguard the Retirement Savings of American Workers

February 13, 2003

Testimony of
Robert A.G. Monks

"Conflict of interest is a very great evil", Senator Jacob Javits, ERISA Forum 1985

The great tragedy of the Enron collapse is the loss of more than a billion dollars in company stock value in employee benefit plans. This committee is considering ways in which this horror can be avoided in the future through judicious amendment of the Employee Retirement Income Security Act of 1974 ("ERISA"). The language and structure of ERISA consistently evoke the historical common law of trusts, of which one of the most consistent and inveterate components is the requirement that trustees/fiduciaries act "solely" in and administer the trust assets "for the exclusive... benefit" of plan participants. The English language cannot communicate greater specificity or be less ambiguous.

The United States financial services industry is riddled with conflicts of interest, which have been exacerbated with the elimination of many restraints on conglomeration in recent years. The fact of conflict is not exceptionable. The issue is how this conflict is resolved. Today, the financial industry is volunteering to pay damages and reorganizing its service delivery because of damages arising out of poorly reconciled conflicting interests. There is no end in sight. Everyone wants to put behind them as quickly and thoroughly as possible the damages created by careless and willful abuse. It is indeed, odd, to contemplate proposed legislation to license conflicts.

The drafters of ERISA were acutely aware of the problem of conflicts and introduced the concept of "prohibited transactions" in order to minimize their potential for destructive impact. On the occasion of a conference commemorating the tenth anniversary of ERISA, Senator Jacob Javits, one of the primary movers of the legislation and then in poor health, was

asked: "Can we not eliminate the 'prohibited transactions' concept and substitute a 'facts and circumstances' test?". Javits asked for the lunch hour to reflect on the question. When he returned, he famously said, "We are dealing with a very great evil and we must continue the absolute prohibition."

It is important to remember there is no obligation on any employer to provide retirement income programs. Policy makers must never lose sight of the need for companies to have real incentive to create plans. Public policy should incline employers to volunteer retirement and savings plans for their employees; the same public policy should encourage the use of employer securities, not as a favored species, but as yet another way to facilitate voluntary saving and prefunding of retirement expense. The difficult policy question is to define the scope of the obligations of trustees with respect to employer securities in pension portfolios. Under the provisions of ERISA governing the preponderance of defined benefit plans, there is an absolute prohibition against plans holding more than 10% of the total assets in company equities. However, under the provisions relating to ESOPs and other defined contribution plans, higher percentages are allowed, even encouraged. There is inconsistency. There are unresolved problems of conflict for even an "independent" trustee.

At the time of this testimony, State Street Bank as a special trustee has asked for court instructions as to how to balance its seeming conflicting obligations as trustee of the United Airlines ESOP in the ongoing bankruptcy proceedings. The inconsistency can be resolved only through enforcing trustees' obligations rigorously to obey the "exclusive benefit" rule. Can one look at the Enron situation and see any evidence that the trustees of the employee benefit plans skeptically monitored the functioning of management "solely" in the interest of plan participants? Of course not. Why, such vehemence? In order to point out the real problem. What really caused the losses suffered by the Enron employees? Management and director failures – yes! But, amendment to ERISA can not address that problem.

As we have noted above, there is no failure of language defining the scope of the ERISA fiduciary's obligations. There has been, alas, an almost total failure of enforcement of this obligation by the Employee Benefit Security Administration ("EBSA"), formerly the Pension and Welfare Benefits Administration ("PWBA") of the Department of Labor ("DOL"). Until and unless this problem is solved, or at least mitigated, new language purporting to shelter employees from trustee negligence is redundant,

misleading and, in fact, contributory to the real problem. Words will not fix conduct in the absence of enforcement.

Let's pause to consider briefly what is proposed. In the language of its sponsors: the proposal "allows employers to provide their workers with access to high-quality investment advice. Under the bill, financial service providers may provide specific investment advice to workers as long as they fully disclose any potential conflicts or fees. It also retains important safeguards and includes new fiduciary protections to ensure that participants will receive advice solely in their best interests." Under existing law (Interpretational Bulletin 96-1), a trustee may provide appropriate investment advice to beneficiaries using plan assets. The trustee is now inhibited from making investment advisory arrangements only with conflicted advisors. There is no shortage of qualified advisors. There are many who are prepared to offer competitive services at market rates. What is the benefit to whom of enabling conflicted advisors to participate, beyond the providers' natural desire for more business where they already have a relationship? Is this in essence the Fidelity Welfare Act? [I mention Fidelity with respect for its entrepreneurial dominance in this field.]

Investment advice should be considered in two categories. In the case of plans where employer securities comprise more than ten percent of the total assets, beneficiaries should be advised to consider the benefits of diversification. This kind of advice can be delivered simply and directly almost in the form of health warnings on cigarette packs. Beyond employer securities, advice has to do with asset allocation and the choice of securities. We can pause and consider how three million federal employees have dealt with this since the passage of the Federal Employees' Retirement Security Act of 1986 and the creation of a federal Defined Contribution scheme. Initially, employees were given three security choices – a special bond fund, a bond fund and an equity index – which has been the S&P 500. In recent times, two more options have been added. The experience with the Thrift Investment Board (created under FERSA) has been sufficiently satisfactory to encourage investigation of this mode for all DC plans. In brief, there are alternatives tested on a fair sample of the American people for over fifteen years which could obviate starting down the slippery slope of eliminating conflict of interest prohibitions.

The problem presented by the Enron employee losses is not the need for clearer language describing rights. The problem is the practical one – how does an individual enforce these rights? How does a plan participant get

his money back from a faulty fiduciary? Unhappily, neither of the two alternatives - private litigation or effective government enforcement - provides much hope.

ERISA does not give individual employees or beneficiaries the right to bring breach of fiduciary duty cases seeking their own compensatory damages. Although individual employees or beneficiaries may bring actions on behalf of a plan against a trustee for breach of fiduciary duty and obtain in such actions restitutionary remedies to reimburse the plan for its losses, the structure of ERISA as it now exists deters such actions and makes them a practical impossibility. There is also no money available from which to pay contingent fees to the employees' lawyers. Employees do not have the authority to dedicate plan assets to the payment of their lawyers' fees. The difficulty is that there is very little practical incentive for most employees, particularly non-management employees, to bring such actions, where there is no direct economic return to the employee and no direct economic recovery to support a contingent fee to the employees' lawyer. This does not mean that there are no cases in which employees can or have brought suits. (Attached as Exhibit I is the opinion of Attorney Peter Murray, published as Appendix II, in my The Emperor's Nightingale)

The amendment proposers boast: "The Pension Security Act would fix outdated federal laws and allow employers to provide their workers with high-quality, professional investment as an employee benefit, but also includes key safeguards to protect the interests of the workers and investors." It must be a commentary on the times in which we live that restriction against conflict of interest can be characterized as "**outdated federal laws**".

EBSA from its beginnings has been "tasked" under ERISA with responsibilities well beyond appropriations or institutional skills. There was a rather rude aphorism at the time of signing ERISA on Labor Day 1974. The bill's preparation had taken eleven years after President Kennedy on his way to Texas had signed the authorization of the study commission. It was said that ERISA, an act which pre–empted all state legislation in its field, would need be implemented by federal agencies having particular competency in the areas of personnel and finance. There were such, the Departments of Labor and Treasury. So, they gave the people to the Treasury and the money to the Labor Department. The few senior civil servants who were attracted to Labor were – and are – of the highest quality, but the Department had no cultural familiarity with the complexity of the financial service industry.

The real need is either to provide adequate funding for EBSA to create an enforcement capability and culture to monitor the "largest lump of money in the world" or to pass amending legislation giving the SEC or the Treasury, federal institutions with appropriate culture and competency, enforcement responsibility.

The ultimate fiduciary failure with respect to the Enron collapse was shareholder inactivity. Shareholders were responsible for the board. In the United States today, voting control of virtually all publicly traded companies rests in trustees, the scope of **whose responsibilities can be defined under existing federal law.**
EBSA has for almost twenty years been the leader in defining fiduciary obligation to inform themselves and to take appropriate remedial action with respect to companies whose securities are held in the portfolio. (U.S. Department of labor, Interpretive Bulletin 94-2, relating to written statements of investment policy, including proxy voting or guidelines, 7/29/94). EBSA has in recent weeks been paid the compliment of imitation by the SEC and the Federal Reserve, who respectively regulate mutual funds and bank trusts. The SEC has required appropriate activism for investment companies and advisors subject to the 1940 Act; the Fed has before it a comparable requirement for the trust departments of national banks. All that is now required is Administration leadership and the convening of a meeting of the Assistant Secretary of Labor for EBSA, the Chairman of the SEC and the appropriate Governor of the Federal Reserve. The agenda at that meeting should be the promulgation of "one government" policy on the duties of fiduciaries with respect to ownership responsibilities for securities held in the trust portfolio. This "reform" requires no new laws, no new agencies, and does not involve the elimination of time honored restraints.

Increasing evidence is emerging in aid of the conclusion that shareholder activism tends to protect against loss and to enhance value. A company comparable in many ways to Enron is Waste Management. These were the star clients of Arthur Anderson, whose partners were cited by the SEC in the Waste Management case long before Enron became a problem. Waste Management shareholders became actively involved; many of the leading institutional investors (including no ERISA plans) attended annual meetings and pressed directors and committee chairs for explanation. As of today, neither employees nor shareholders of WMX have losses. The question of trustee obligation to take appropriate action is not a simple one. It is, however, noteworthy that over the last twenty years, **there has never been a situation in which a private company pension fund (subject to ERISA, with the exception in recent years of CREF) has been publicly**

identified as an activist shareholder. During this same time, public pension funds – not subject to ERISA - have very prominently and very profitably been activist. Perhaps, not coincidentally, **there has never been an enforcement action initiated by EBSA for the failure of ERISA fiduciaries to act in appropriate situations.** While the whole field of shareholder activism is in the process of gradual evolution, one cannot simply dismiss the double failure – failure by the largest shareholder group and failure by the regulatory agency – as an ignorable inconvenience.

EBSA enforcement failure reached its apogee in the recent merger of Hewlett Packard and Compaq. There is attached to this testimony as Exhibit II an article that I wrote for *Pensions & Investments* at the time of the merger in the spring of 2002, and, as Exhibit III, my fantasy as to a Decision by the Delaware Federal Court if EBSA had intervened and argued the ERISA issue in that case. The conduct in that case of Deutsche Asset Management is a matter of record and, as a plan fiduciary, accepting a fee for soliciting proxy vote, a per se violation of ERISA. This was not a small matter – the most important merger of 2002 would not have occurred had the law been enforced.

At the request of the then Chairman of the Senate Labor Committee the Government Accounting Office ("GAO") has scheduled a review of this matter to commence in March 2003 and will later in the year issue a report on its conclusions concerning EBSA enforcement of fiduciary requirements under ERISA. If there is a finding of systemic failure, the Congress would do well to listen to its auditor and pause before adding new responsibilities on to an already dysfunctional process. In the meantime, it is well to reflect that informed involvement by motivated owners is the best protection against the collapse of corporate values.

Robert A.G. Monks
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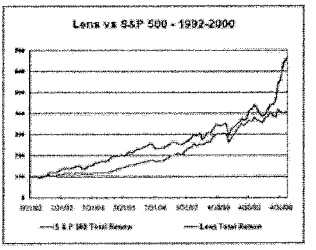
Robert A.G. Monks is the publisher of http://www.ragm.com, which is focused on the assembly and dissemination of information and opinion about global issues of corporate governance. His principal occupation is the development of ideas harmonizing corporate energies with the long-term interests of Global society. Mr. Monks was the founder of Institutional Shareholder Services, Inc., and served as its president from 1985-1990. ISS is now the leading corporate governance consulting firm, advising shareholders with assets in excess of $1 trillion on how to vote their proxies. He founded the investment fund known as LENS, which since 1992 has developed the "institutional activist" mode of investment. The fund has achieved returns in excess of the S&P average throughout its life and has exceeded them by over 100% during the last three-year period.



Since 1998, in partnership with British Telephone Pension Scheme to promote the same investment principles in the United Kingdom, he founded Hermes LENS Asset Management Company of which he serves as Joint Deputy Chairman. This fund has, also, exceeded its index performance standard. Mr. Monks serves as the President of Henley Management College's Center for Board Effectiveness.

He is a graduate of Harvard College (BA '54), and Harvard Law School (LLB '58). He was a partner in a Boston law firm and served as vice president of Gardner Associates, an investment management company. He was president and chief executive officer of C.H.Sprague & Son Company, a coal and oil concern and served as a board member and chairman of the Board of The Boston Safe Deposit & Trust Company and the Boston Company. He served as director of the United States Synthetic Fuels Corporation through appointment by President Regan who also appointed him one of the founding Trustees of

the Federal Employees' Retirement System. He served in the Department of Labor as Administrator of the Office of Pension and Welfare Benefit Programs having jurisdiction over the entire U.S. pension system.

Mr. Monks has served as a member of the board of directors of ten publicly held companies including most recently Tyco International, The Jefferies Group and The Boston Company. He has spoken, written and testified widely on corporate governance matters over the past twenty years. These materials are largely available at www.thecorporatelibrary.com, including the full text of the first of three books, he co-authored with Nell Minow, Power and Accountability (Harper Business, 1991). With Nell Minow, he also wrote Corporate Governance (Blackwell Publishing 1995), the 2d edition published March 2001, and Watching the Watchers (Blackwell Publishers, 1996). He wrote The Emperor's Nightingale (Capstone, April 1998) and The New Global Investors: *How Shareowners Can Unlock Sustainable Prosperity Worldwide* (Capstone, May 2001). Mr. Monks was also the subject of a biography chronicling the corporate governance movement – A Traitor to His Class - by Hilary Rosenberg published by Wiley in 1999.

September 2002

Law Office of
Peter L. Murray
89 West Street
Portland, Maine 04102

Phone: 207 879-1533 Fax 207 879-9073

January 25, 2001

Mr. Robert A. G. Monks
Lens, Inc.
45 Exchange Street
Portland, ME 04101

Re: Employee ERISA Remedies for Fiduciary Investment Mismanagement

Dear Mr. Monks:

You have asked my opinion whether employee participants in employee benefit plans maintained by Stone & Webster, Inc., have a reasonable avenue of legal recourse against Putnam Fiduciary Trust ("Putnam"), the ERISA Trustee of Stone & Webster's employee benefit plans, for 1) Putnam's improvident investment of plan funds in common stock of Stone & Webster only a few months before that firm declared bankruptcy, and 2) Putnam's failure to take any affirmative action as Stone & Webster's single largest shareholder to avert the firm's financial collapse. Based on the facts as related to me, and based on my own legal research and that of Barbara T. Schneider, Esq. of Murray, Plumb & Murray, Portland, Maine, it is my opinion that the Employees Retirement Security Act of 1974 as it is currently construed by the courts does not as a practical matter provide the Stone & Webster employees with a viable legal remedy for the above cited actions and inaction on the part of Putnam and the employees' resulting financial loss.

Material Facts

You have advised me of the following material facts, on which this opinion is based.

Stone & Webster, Inc., a Delaware corporation with a principal place of business in Boston, Massachusetts, has been primarily an engineering and construction company, although it has been engaged in other businesses, including at one time securities underwriting and, more recently, cold storage. It has sponsored various employee benefit plans, including a pension plan and various employee thrift and stock ownership plans. These employee plans have invested substantially in Stone & Webster stock and have been for a long time collectively the Company's largest shareholder, holding nearly 33.9% of the Company's outstanding common stock. Putnam Fiduciary Trust, of Quincy, Massachusetts, serves as Trustee of these plans and is responsible for investment of plans' funds and administration of the plans' portfolios. Putnam is a "named fiduciary" within the meaning of the Employee Retirement Income Security Act of 1974. *See* 29 U.S.C. §§ 1102(21)(A) & 1102(a) (ERISA).

Several years ago as the result of shareholder initiatives spearheaded by Lens, Inc. the Company's Board of Directors adopted certain governance reforms including election of at least one truly independent director. The Board also resolved to focus the Company's activities on its core engineering business and divest itself of extraneous assets and investments, including the Company's cold-storage properties.

Robert A.G. Monks

In 1998 the Company experienced a cash shortage as a result of cancellation of major construction projects abroad. At the same time Company management inexplicably abandoned its earlier efforts to sell the cold storage properties and instead made a major new investment in cold storage warehouses. The cash crisis intensified.

Late in 1999 Company management and Putnam entered into an arrangement to generate needed cash by the sale of additional shares of Stone & Webster common stock to the Stone & Webster employee benefit plans. On December 14, 1999 Putnam purchased with plan funds one million shares of Stone & Webster common stock at a price of $15.35 per share.

Within four months the stock price had tumbled, and on June 2, 2000, a scarce six months after Putnam had bought the stock the Company declared bankruptcy. The employee benefit plans had lost a total of approximately $75,000,000 on their Stone & Webster stock, including nearly $14 Million in this most recent investment.

You have suggested that Putnam's conduct in connection with this investment may give rise to fiduciary liability in at least two senses:

1) The decision to buy more Stone & Webster stock was a very bad one at the time it was made. There were abundant indications that the Company was in trouble. Its engineering business was floundering. The 180% shift on the cold storage business was inexplicable. The independent director had resigned. These circumstances were such as to lead a prudent trustee to use extreme caution in considering a further investment of fiduciary funds. Under these circumstances Putnam's decision to invest $15 Million in plan funds in Stone & Webster stock, possibly without sufficient analysis and due diligence, may well not have been the action of a prudent person in the management of plan funds.

2) Putnam took no action in its position as Stone & Webster's largest single shareholder, owning more than one-third of the company, to investigate the Company's circumstances, to work with other large shareholders to effect positive change, or to challenge management or to hold it accountable. While one cannot expect much pro-active behavior from small shareholders, a shareholder with the relative voting power of Putnam as fiduciary of all the employee plans has real options to protect its investment and can exercise a strong positive influence on management and the state of affairs at the company. Moreover, the proportion of its portfolio invested in Stone & Webster stock meant that the consequences of Putnam's failure properly to manage, monitor and exercise the ownership rights inherent in this investment would be particularly catastrophic. Putnam took no action to exercise its rights as Stone & Webster's largest single shareholder but let management continue in a counter-productive and ultimately self-destructive downward spiral. It can be persuasively argued that such inaction by a plan fiduciary (whose sole duty is to the employee participants of the plans) can smack of conflict of interest and rise to a breach of fiduciary duty in the administration of the plan's invested assets.

At least the first basis for liability finds support not only in reported decisions under ERISA, but also in the Regulations issued by the Labor Department under ERISA.

> Section 404(a)(1) of ERISA requires, in part, that plan fiduciaries must act solely in the interest of participants and beneficiaries of a plan and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like

> character and with like aims. A Plan may be permitted to acquire qualifying employer securities under section 408(3); however, if the acquisition is not prudent (because, for example, of the poor financial condition of the employer) or is not for the exclusive purpose of benefiting participants and beneficiaries (such as an acquisition that is made primarily to finance the employer), the responsible plan fiduciaries will remain liable for any loss resulting from a breach of fiduciary responsibility.

Department of Labor, Opinion of the Office of Regulations and Interpretations, 96-08A (1996).

If the foregoing facts were asserted and proven in court one would expect that Putnam would be held liable to reimburse the Stone & Webster employee plans for the losses sustained by reason of this most recent investment in Stone & Webster stock. ***The question, though, is who is in a position to bring Putnam to court and hold it accountable to provide redress to the employee plans which it harmed***?[1]

Question Presented

Does ERISA give Stone & Webster employees who are participants in the employee benefit plans administered by Putnam practical ability to obtain redress from Putnam for the harm suffered by the employee benefit plans and themselves as plan beneficiaries? As stated above and for the reasons hereafter set forth, the provisions of ERISA as construed by the courts do not give adequate support or incentives for employee participants to seek and obtain redress for Trustee malfeasance under the circumstances posed, even assuming that the Trustee is guilty of either or both of the breaches of fiduciary duty described above.

Reasons for Opinion

The Employees Retirement Income Security Act of 1974 (ERISA) was hailed at its enactment as legislation giving important rights to employee beneficiaries of private pension and employee benefit plans. For the first time, the entire group of obligations and relationships involved in the nation's private pension system were brought under one regulatory scheme. The obligations of sponsors and administrators of employee benefit plans were federalized and clarified. The "prudent man rule" was adopted to govern the responsibilities of plan fiduciaries with respect to investment of plan funds. All of these measures, although creating some added complexity in employee benefit administration, have tended to rationalize and improve the administration of employee benefit plans. On the other hand, it is now evident, if it was not evident at the time ERISA was enacted, that the portions of ERISA which provide remedies for breach of ERISA-created fiduciary obligations seriously limit the practical ability of employee participants in ERISA plans to obtain legal redress either for themselves or for the plans of which they are members.

1. Employee Claims for Fiduciary Liability under ERISA

The provisions of ERISA that provide remedies for breaches of fiduciary duty by trustees are found in 29 U.S.C. § 1109 and 1132. Read together, the statutory sections of ERISA that provide the remedy for breach of fiduciary duty give both individual plan participants, beneficiaries, and fiduciaries, as well as the Department of Labor standing to enforce ERISA's fiduciary requirements by suit in court.

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[1] It has been decided that other shareholders of Stone & Webster do not have standing to enforce the ERISA fiduciary obligations of Putnam. *Lens, Inc. et al. v. Stone & Webster, Inc. et al.*, Civil Action No. 94-10787-REK, U.S. District Court, D. Massachusetts, June 29, 1994.

Individual employees or beneficiaries may bring claims against fiduciaries both in their individual capacities, *see* 29 U.S.C. § 1132(a)(3) (allowing generalized relief) and on behalf of the plan as a whole, *see* 29 U.S.C. § 1132 (a)(2) (allowing specific relief under section 1109). *See Varity Corp. v. Howe*, 516 U.S. 489 (1996) (recognizing right of individual plan members in breach of fiduciary duty case to bring claims pursuant to 29 U.S.C. § 1132(a)(3) to seek reinstatement of benefits that were given up as a result of fiduciary's breach). ERISA does not, however, give individual employees or beneficiaries the right to bring breach of fiduciary duty cases seeking their own compensatory damages. Although individual employees or beneficiaries may bring actions on behalf of a plan against a trustee for breach of fiduciary duty and obtain in such actions restitutionary remedies to reimburse the plan for its losses, the structure of ERISA as it now exists deters such actions and makes them a practical improbability.

The only circumstances under which a plan participant, fiduciary, or beneficiary can complain in her own name of actions of the trustee are those cases in which the individual can establish some sort of individualized harm. For example, in *Varity,* after a company that sponsored a self-funded employee welfare benefit plan decided to transfer the assets of all of its failing divisions to a new company, the employees were induced by the company in its capacity as plan administrator to release it from its obligations under its plan and "sign up" for benefits in the new company's plan. The new company failed and the employees successfully brought suit to be "reinstated" into the plan of the original employer. In the case of *Varity*, the employees were able to show some sort of individualized harm to their own benefit packages, which the Supreme Court enabled them to pursue under 29 U.S.C. § 1132(a)(3).

Under this doctrine, the most common category of cases brought under ERISA are claims by employees for withheld or terminated benefits. Such claims involve individualized harm to the employees. They also produce individual economic recoveries which will support the employment of counsel and contingent fee arrangements.

In cases where a fiduciary has mismanaged plan investments, the harm is to the plan as a whole rather than individual employees, and will not support individual actions. Although employees clearly have the right to bring suit for such harms, the proceeds of such suits go directly to the benefit of the plans. There is nothing which goes to the employee or employees who go to the trouble to bring the suits.

There is also no money available from which to pay contingent fees to the employees' lawyers. Employees, although authorized to bring suit for the benefit of employee plans, do not have the authority to dedicate plan assets (including amounts recovered for the benefit of the plan) to the payment of the employees' lawyers' fees. There is thus very little incentive for employees to bring such suits and no means by which to finance them.

This does not mean that there are no cases in which employees have complained of breaches of fiduciary duty by trustees and other fiduciaries. There have even been cases where employees have been able to maintain breach of fiduciary claims against trustees that have invested in employer stock, when the employees have been able to demonstrate that the trustees abused their discretion. *E.g. Moench v. Roberston*, 62 F.3d 553, 571 (3rd Cir. 1995) (reversing summary judgment in favor of trustee and remanding for factual determination of whether trustee had divided loyalties and made an impartial investigation of all options). The difficulty is that there is very little practical incentive for most employees, particularly non-management employees of large corporations, to bring such actions, where

there is no direct economic return to the employee and no direct economic recovery to support a contingent fee to the employees' lawyer.

While claims in behalf of numerous employees against a single wrongdoer would seem to be well suited to class action treatment, ERISA effectively displaces the class action by authorizing any employee to bring suit in behalf of the plan, and limits the opportunity of employees to bring claims in their own interests by limiting employees' ability to obtain compensatory damages. *See McLeod v. Oregon Lithopring, Inc.*, 102 F.3d 376 (9TH Cir. 1996) (holding that while individuals may bring breach of fiduciary duty claims against a plan administrator as a result of the Supreme Court's holding in *Varity*, such claims are limited to equitable relief and employees may not pursue compensatory damages); *see also Hoeberling v. Nolan*, 49 F.Supp. 575 E.D. Mich. 1999).

It is unlikely that even a group of employees will wish to bring a suit which will only redound indirectly and in small part to their benefit. The indirect per-employee effect of even egregious losses such as those sustained by the Stone & Webster plans in this case is unlikely to provide enough incentive to cause employees to initiate a David-and-Goliath battle with a multi-million dollar adversary such as Putnam Fiduciary Trust, to recover funds which will only ultimately redound in tiny proportion to their individual benefits.

2. Actions by the Department of Labor for the benefit of employees harmed by fiduciary misconduct.

One option for the Stone & Webster employees might be to try to convince the U.S. Department of Labor (DOL) to bring suit and obtain redress in their behalf. An aggressive program of public enforcement of ERISA fiduciary standards by DOL-instituted litigation could in part make up for the lack of resources and incentives for private enforcement by employees and their lawyers. While the DOL has occasionally brought a case raising issues of fiduciary liability for poor investment decisions, the relative rarity of reported cases of this kind suggests that such actions may be more the exception than the rule. One would expect that the Department of Labor's limited resources must be allocated to those programs it considers most important for the nation as a whole, and may not suffice to provide redress to individual groups of employees harmed by investment mismanagement by their plan fiduciaries. Indeed, the policy of the DOL in recent years has been to emphasize bringing erring fiduciaries into "voluntary compliance" rather than holding them financially responsible for the effects of their lapses on the plans in their trust. *See, e.g.* U.S. Department of Labor, Fact Sheet: Voluntary Fiduciary Correction Program, www.dol.dol/pwba/public/pubs/vfcpfs.htm. Although an enterprising employee might attempt to convince the DOL to litigate the issues in this case, given the relative novelty of at least the second issue, one could have no confidence that the DOL would make this one of the relatively few fiduciary enforcement actions that it would bring in court.

3. Attorneys' Fees in ERISA Claims

ERISA does attempt to mitigate the burden of litigation on successful parties by authorizing awards of attorneys' fees in the discretion of the court. However these provisions, as construed to date, tend to exacerbate rather than mitigate the disincentive to plaintiffs to undertake claims of the kind involved in the Stone & Webster case.

The terms of 29 U.S.C. §1132(g) provide that "the court in its discretion may allow a reasonable attorney's fee and costs of action to either party." For potential employee plaintiffs the message of this section is clear. Any compensation from the defendant for the employees' counsel will be only at the discretion of the court:

> "Unlike other fee-shifting statutes . . . ERISA does not provide for a virtually automatic award of attorneys' fees to prevailing plaintiffs. Instead, fee awards under ERISA are wholly discretionary."

See Cottrill v. Sparrow, Johnson & Ursillo, Inc., 100 F.3d 220, 225 (1st Cir. 1996).

Most circuits that have addressed the question have refused to adopt any "mandatory presumption that attorneys' fees will be awarded to prevailing plaintiffs in ERISA cases absent special circumstances. " *Id.* Instead, attorneys' fees are awarded after consideration of five factors, namely:

> "(1) the degree of the opposing parties' culpability or bad faith; (2) the ability of the opposing parties to personally satisfy an award of attorney's fees; (3) whether an award of attorney's fees against the opposing party would deter others from acting under similar circumstances; (4) whether the parties requesting fees sought to benefit all participants and beneficiaries of an ERISA plan or to resolve a significant legal question regarding ERISA: and (5) the relative merits of the parties' positions."

Sage v. Automation, Inc, Pension Plan and Trust, 931 F.2d 900 (10th Cir. 1991) (attorneys' fees denied to successful plaintiffs on remand at 777 F. Supp. 876 (D. Kansas 1991).

Thus, a plaintiff seeking to establish a fiduciary's liability to a plan for breach of duty will have to reckon with the possibility that even if successful, payment of attorneys fees by the other party is not guaranteed. And awards of fees have tended to be relatively modest, computed on an hourly basis without multipliers to reflect the actually contingent nature of such compensation. *See, e.g. Bruner v. Boatmen's Trust Company*, 918 F. Supp. 1347 (E.D. Mo. 1996) (award of attorneys fees equal to about 10% of amount recovered for the fund based on hourly rate of $100 without enhancement).

Moreover, the provisions of ERISA permitting awards of attorneys' fees go both ways. An unsuccessful plaintiff may be ordered to pay the fees incurred by the defendant. Although the five factors that most courts use to determine whether or not attorney's fees should be awarded tend to discourage awards to prevailing defendants, *see Salovaara v. Eckert,* 222 F.3d 19, 28 (2nd Cir. 2000), there are instances where losing plaintiffs have been required to pay attorney's fees incurred by the other side, *Operating Engineers Pension Trust v. Gilliam*, 737 F.2d 1501 (9th Cir. 1984).

The effect of ERISA'S fee-shifting provisions in the area of claims for fiduciary liability is to deter all but the most cut-and-dried "slam-dunk" cases of trustee malfeasance. Without some guarantee of reasonable compensation, or at least a good chance for a real contingency fee, plaintiffs' attorneys can scarcely be expected to undertake complex litigation against corporate trustees. And the risk of being required to pay the adversary's fees will screen out all but the most obvious and routine claims, certainly any cases that raise new theories or attempt to cut new ground.

Robert A.G. Monks

While it might occasionally be possible to find a lawyer willing to prosecute a simple and relatively obvious case of fiduciary negligence or incompetence, for the reasons above stated, more serious cases such as the Stone & Webster case, are very likely to go begging. This is particularly the case if the claim is somewhat novel, as would be the case with the second potential claim described above. While it is perfectly logical to hold that a trustee who neglects the prudent management of an investment once bought is as negligent as one who carelessly makes the investment in the first place, the fact that this claim is not specifically established by statute and is not well known in the case law would make it extremely unlikely that a plaintiff would assert it if it had to pay its own attorney's fees or, potentially, pay its opponent's attorney's fees.

Conclusion

This statutory scheme, as construed to date by the courts, means that at least some of the obligations ERISA imposes on plan fiduciaries may be illusory in that there is no effective means for the employee beneficiaries to hold the plan fiduciaries accountable. This state of affairs is not in accord with the stated purposes of ERISA, but it appears to be an undeniable practical reality.

What would be needed to "even the playing field" would be:

1) Better standards for the award of attorneys' fees in ERISA cases, including a "risk factor" to compensate successful plaintiffs' counsel for the practically contingent nature of such engagements, and standards limiting awards of fees to defendants to egregious cases of plaintiff bad faith.

2) More clearly defined standards of fiduciary responsibility, especially in the area of the fiduciary's exercise of its governance rights and options as a shareholder. This is particularly important where the fiduciary is a major shareholder of the employer, and not only has the ability to exercise shareholder power in the interest of plan participants and beneficiaries, but also is subject to potential conflicts of interest which might impede it in the exercise of this power.

In the absence of either or both of these reforms, not only the Stone & Webster employees, but many others like them, will continue to go without effective practical remedy for serious breaches of fiduciary duty by employee plan administrators and trustees.

My qualifications to render this opinion include several decades of practice experience with employee benefit plans, before and under ERISA, my experience as a litigator in cases involving ERISA issues, and my ongoing work in law academics as Braucher Visiting Professor of Law from Practice at Harvard Law School.

Very truly yours,

Peter L. Murray

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OTHER VIEWS

Pensions & Investments

Unraveling fiduciary conflicts in HP-Compaq merger voting

By Robert A.G. Monks

The past six months have been filled with headlines about failures of checks and balances in our system of corporate governance. To me, the most troubling was the facts that came out of the challenge to the votes cast in the proposed merger of Hewlett-Packard Co. and Compaq Computer Corp. How did Capital Guardian Trust Co., Vanguard Group and Deutsche Asset Management, among other institutions that manage employee benefit assets for Hewlett-Packard, handle the conflicts of interests arising from the HP merger vote?

Several of the largest shareholders of Hewlett-Packard stock were investment managers subject to the fiduciary standards of the Employee Retirement Income Security Act. The conflicts of these investment managers for HP's plans stem from, on the one hand, their legal obligation to act "for the exclusive benefit" under ERISA for plan participants, as the act states, and, on the other hand, their commercial interest in maintaining excellent relationships with a fee-paying customer. What information is available to a plan participant, or a regulator, who wants to know how the managers handled the conflicts?

The influence of these investment advisers extended beyond the assets that they managed for the company whose shares they were voting. Beyond their investment management of HP pension assets, these institutions managed other accounts with substantial holdings of HP common stock, which they had the power to vote. Capital Management and Research Co., Capital Guardian Trust's affiliate, was the largest shareholder of HP, holding approximately 67 million shares, or 3.45% of the total, while Deutsche is attributed by the judge who ruled on the case with either 17 million or 24 million shares. Vanguard with 32 million shares held 1.64% of the total.

If ERISA fund managers want to avoid the scandal and liability of Wall Street analysts, they must act quickly to make sure all conflicts are resolved in favor of plan participants and that all proxy voting policies and all votes in contested matters are disclosed to those for whom they act as fiduciaries.

Most troubling was evidence showing that Deutsche entered into an incentive agreement with HP under which it would be paid $1 million for providing proxy services in connection with the proposed merger, which would be doubled in the event of success. Apparently, Deutsche switched its vote following negotiation of this fee and a meeting set up by its investment banking side as a courtesy to its customer, HP.

The one conflict of interests resolved in a manner that was publicly disclosed was at Barclays Bank, with 53 million shares, the second largest holder. Patricia C. Dunn, co-chairman and global chief executive of Barclays Global Investors, was also a director of Hewlett Packard.[1] To deal with this conflict, Barclays delegated its fiduciary discretion in voting to an independent professional, Institutional Shareholder Services Inc.

This is consistent with the ruling in Leigh vs. Engle, which remains the controlling legal standard. When fiduciaries have relationships such that "exclusive benefit" is literally impossible, attention "focuses on the potential for conflict of interest between the fiduciaries and the plan beneficiaries. When the potential for conflicts is substantial, it may be virtually impossible for fiduciaries to discharge their duties with an 'eye single' to the interest of beneficiaries, and the fiduciaries may need to step aside, at least temporarily, from the management of assets where they face potentially conflicting interests."

The question is whether Capital Guardian, Vanguard and Deutsche as fiduciaries voting as much as 6% of the total outstanding shares — enough to change the outcome — appropriately dealt with the conflicts of interests each of them had as a result of their duties as fiduciary under HP's employee benefit plans. Ideally, like Barclays, they should have stepped aside. If not, they owe the plan participants whose retirement money they are investing a public statement of their procedures and criteria for determining the appropriate proxy vote in a matter involving a client.

The issue presented to the Delaware Chancery Court was far from the question that should be raised under ERISA. In Delaware, the challenge was to HP management — did the timing of the new million-dollar fee paid to Deutsche just before the vote switch constitute corruption? The standard of proof is so high that it would require documentation of an actual trade of money for votes.

But a challenge under ERISA would put the burden of proof on the conflicted party to demonstrate that their conflicted interest did not impinge on their "exclusive benefit" duty. "Fiduciaries must be able to defend any decision on voting or shareholder issues as having been made solely, to further the economic interests of plan participants and beneficiaries," fiduciary expert Betty Krikorian wrote. "If the fiduciary has conflicting interests, the decision will be scrutinized even more carefully."

It is difficult to imagine a clearer instance of conflicted interests or a more investigation-worthy set of events than we saw with Deutsche Bank's vote at HP. I hope and trust that Department of Labor and Securities and Exchange Commission investigators are going through their records already. The provisions in that contract for doubling the fee in the event of success obviate any possible Chinese wall and make impossible the notion of any fiduciary action "for the exclusive benefit" of anyone other than Deutsche employees. The other fund managers may have managed their conflicts better, but they have an obligation to let their plan participants know how they voted and how that decision was made.

If ERISA fund managers want to avoid the scandal and liability of Wall Street analysts, they must act quickly to make sure all conflicts are resolved in favor of plan participants and that all proxy voting policies and all votes in contested matters are disclosed to those for whom they act as fiduciaries.

Post-Enron reforms are putting a lot of pressure on public companies to develop and publish corporate governance policies. They would spell out clearly and comprehensively how the board handles the conflicts of interests that are inevitable in a system where directors acting on behalf of the shareholders are selected and paid by management. I'd like to see institutional investors develop and issue their own corporate governance policies for exactly the same reason — to protect against conflicts of interests and to give investors information that will help them make better choices. ■

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[1] Robert A.G. Monks *has a website, www.ro[illegible]s, focusing on global corporate governance. He [illegible] founder of Institutional Shareholder Services Inc., the LENS Fund, Hermes Focus Lens Asset Management and The Corporate Library. He is a former administrator of the Department of Labor's Office of Pension and Welfare Benefits Administration. He is the author of several books on corporate governance; the latest is "The New Global Investors," published by Capstone Publishing Ltd. in 2001.*

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Simulated document prepared by R.A.G. Monks – this is not an actual court case.

UNITED STATES DISTRICT COURT, DISTRICT OF DELAWARE

ELAINE CHAO, Secretary of Labor,

Plaintiff

v.

HEWLETT-PACKARD COMPANY ("HP"),
et als.,

Defendants.

OPINION

Date Submitted: April 30, 2002
Date Decided: May * , 2002

Scott, A.W., *District Judge.*

The Secretary of Labor (the "Secretary") seeks an order: first to declare Deutsche Bank's ("DAM"), Capital Guardian Trust Company's ("Capital") and Vanguard's ("Vanguard") final voting proxy cards for the April meeting of shareholders of HP to be invalid and second to require a new meeting must be held to reconsider the proposed merger.

This action was filed by the Secretary immediately following the decision of Chancellor Chandler in Hewlett v. Hewlett-Packard Company C.A. No 19513-NC in the Court of Chancery in and for New Castle County on April 30, 2002 which arose out of the same subject matter. The Secretary submits to this court the entire record in that transaction together with a memorandum of the issues therein relevant to the Employee Retirement Income Security Act of 1974 ("ERISA").

The record makes clear that participants in employee benefit plans subject to ERISA hold a substantial portion of the outstanding stock of HP. The Secretary has undertaken this action because the size of employee benefit plan shareholdings in all public companies is so large that it is essential –notwithstanding that neither party raised this issue in the Delaware proceedings - that the rules governing the voting of stock subject to ERISA be clear.

ERISA requires that fiduciaries administer plan assets for the *exclusive benefit of plan participants.* Fiduciaries are not allowed to take into account their own commercial interests when they exercise their fiduciary discretion respecting the management of plan assets; they must act *solely* for the beneficiaries. There are valid policy reasons in favor of permitting management vast leeway to expend resources to solicit proxy support; it is inherent in the corporate scheme that management will use corporate personnel, relationships and cash to vindicate its judgment. Chancellor Chandler found that such conduct was appropriate in this situation. However, there is a limit. Management may not use its resources to purchase fiduciary discretion, or, to put it more prexisely, it is contrary to law and to public policy for an ERISA fiduciary to "sell" its fiduciary responsibility.

Unhappily, the vagaries of proxy contest mechanics do not yet permit this court certainty as to who, in fact, were the shareholders of HP and how they voted. We can, however, glean certain facts with some confidence. Capital Guardian Trust Company ("Capital"), Vanguard Group ("Vanguard") and Deutsche Asset Management ("DAM"), among other institutions, perform Investment Management functions for Hewlett Packard Company employee benefit plans. An "Investment Manager" with voting discretion is a fiduciary under ERISA. Moreover ERISA preempts any otherwise applicable state law – including, of course, the law of the State of Delaware - in this area. The definition of fiduciary responsibility is determined exclusively by ERISA.

In addition to their "investment management" of HP pension funds, these institutions managed other accounts with substantial holdings of HP common stock, which they had the power and responsibility to vote. The Capital Group was the largest shareholder of HP with approximately 67 million shares or 3.45% of the total, while DAM is attributed by Chancellor Chandler variously with either 17 or 24 million shares. Beyond the customary commercial desire to retain and expand existing business relationship, Deutsche entered into an incentive agreement with HP under which it would be paid $1 million for providing proxy services in connection with the proposed merger, which would be doubled in the event of success. Vanguard with 32 million shares held 1.64% of the total. The CEO of Barclay's Bank, with 53 million shares, the second largest holder, was also a director of Hewlett Packard. In order to deal with this conflict of interest, Barclay's delegated fiduciary discretion in voting to an independent professional, Institutional Shareholder Services.

Judge Cudahy in Leigh v. Engle (727 F2d 113,122) promulgated what remains the controlling legal standard. When fiduciaries have relationships such that "exclusive benefit" is literally impossible, attention "...focuses on the potential for conflict of interest between the fiduciaries and the plan beneficiaries. When the potential for conflicts is substantial, it may be virtually impossible for fiduciaries to discharge their duties with an 'eye single' to the interest of beneficiaries, and the fiduciaries may need to step aside, at least temporarily, from the management of assets where they face potentially conflicting interests."

The question presented to this court is whether Capital, Vanguard and DAM as fiduciaries' voting respectively 3.45 %, c. 1 %, 1.64 % of the total outstanding shares appropriately dealt with the conflicts of interest each of them had as a result of their duties as fiduciary under HP Employee Benefit plans. An initial question is whether, like Barclay's, they should have stepped aside.

"They must document their awareness of conflict of interest, consider whether they should step down as trustees due to their divided loyalties, and if they chose to remain in office, make a prudent analysis of the situation to determine how best to serve the interests of the participants and beneficiaries."[1] There is no evidence of any of the parties making such an analysis.

In considering the situation of DAM under Delaware law, Chancellor Chandler confronted a very different situation; "...[T]he plaintiff will have the significant burden of presenting sufficient evidence for me to find that DAM was coerced... and that the switch of those votes was not made by DAM for independent business reasons."(p 35) The burden of proving coercion could not be easily met. Notwithstanding DAM's having negotiated a separate service fee contingent on the result of this transaction,[2] the Chancellor concluded "that plaintiffs have failed to meet their burden of proving the existence of such a vote-buying arrangement." [p. 36]. All the evidence was circumstantial.

Under the ERISA standards, the burden of proof is on the conflicted party, DAM, to demonstrate that their conflicted interest did not impinge on their "exclusive benefit" duty. "Fiduciaries must be able to defend any decision on voting or shareholder issues as having been made solely to further the economic interests of plan participants and beneficiaries. If the fiduciary has conflicting interests, the decision will be scrutinized even more carefully."[3]

It is impossible for this court to conclude that DAM has satisfied the requirements of ERISA, having not only an initial conflict - "A problem that investment managers often raise is their belief that a sponsor will withdraw its accounts if the manager does not vote as the sponsor wishes." – but further having negotiated both a service fee, and a contingent fee based on success in the proxy contest. It is difficult to imagine a clearer instance of conflicted interests. DAM is obligated under ERISA to administer (including voting) plan assets "exclusively for the benefit of plan participants." This commits DAM to a fair-minded consideration of the merits of the proposed merger. DAM is also employed by HP management to achieve a specific voting result. Is it possible to conclude that they *can* vote HP stock contrary to the wishes of this same management under conditions in which it is certain that management will learn of this vote immediately after it is cast? Incontestably DAM cannot satisfy the "sole purpose" requirements after soliciting additional pay from HP to secure a positive vote on the

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[1] Section 7.12, Fiduciary Standards in Pension and Trust Fund Management, – Betty Krikorian.

[2] As an expert in this field, I can assure you that fees of this magnitude are not only unusual, they are unique! - RAGMonks

[3] Krikorian, supra.

merger. The provisions in that contract for doubling in the event of success utterly commit DAM to a non fiduciary mode of conduct. It is clear that DAM has violated ERISA and that its purported voting of shares must be voided.

The only facts before this court respecting Capital and Vanguard are that they are ERISA fiduciaries with respect to HP and they have conflicting interests with respect to votes of HP stock in other accounts with respect to the merger. They have not made available any materials to indicate that they have complied with ERISA requirements respecting conflicting interests. It is essential that ERISA fiduciaries have unmistakable guidance as to appropriate procedure.

As Chancellor Chandler has indicated (footnote 93, page 35), the share ownership of DAM alone may be large enough to change the outcome of the proxy contest. Taking into account the clear ERISA violation by DAM and the questions concerning Capital and Vanguard (and, perhaps, others), this court voids the votes of all three parties. The voiding of these votes appears likely to change the result of the vote on the merger from approval to failure. Notwithstanding the commercial confusion involved in delay, this court directs the parties to resolicit the vote of shareholders on the merger proposals.

Signed:

Austin W. Scott, District Judge.

APPENDIX G – SUBMITTED FOR THE RECORD, STATEMENT OF EMPLOYEE-OWNED S CORPORATIONS OF AMERICA (ESCA), WASHINGTON, D.C.

STATEMENT OF
EMPLOYEE-OWNED S CORPORATIONS OF AMERICA

BEFORE THE

HOUSE EDUCATION AND THE WORKFORCE COMMITTEE
SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS

ON

"THE PENSION SECURITY ACT: NEW PENSION PROTECTIONS TO SAFEGUARD THE RETIRMENT SAVINGS OF AMERICAN WORKERS "

FEBRUARY 13, 2003

Introduction

Employee-Owned S Corporations of America (ESCA) is the only organization that speaks exclusively for America's private, employee-owned businesses on the issue of pension reform. ESCA believes that, as Congress contemplates meaningful reforms to provide added pension security for American workers, it is critical that policymakers adopt an approach that seeks to bolster, rather than inadvertently harm, the pension savings of the employees who are owners of private U.S. businesses.

Thousands of non-public companies across America are employee-owned. These companies, the vast majority of which are small- and medium-sized and/or family businesses, are a hallmark of American entrepreneurship. Through their growth, they have helped fuel the national economy by providing increasing numbers of jobs for millions of workers in fields ranging from trucking to tourism, from manufacturing to management consulting.

Employers benefit from employee-ownership

Private employee-owned companies are typically "open book" companies, where employees are informed investors in the company. Employee stock ownership allows all employees, not just top executives, to have a stake in the success of their company. Government and private studies clearly document that employee ownership leads to

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increased productivity and compensation, worker satisfaction, and lower turnover - all of which are crucial to a private business' financial success and growth.

Aspen Systems Corporation (Aspen), a service company primarily fulfilling federal government contracts, is a private company wholly owned by the Aspen Employee Stock Ownership Plan ("ESOP"). Aspen would have been sold by its parent company had it not become employee-owned. The ESOP structure allowed Aspen to grow from $58 million in sales and 1,000 employees in 1993 to $158 million in sales and more than 2,000 employees in 2002. Aspen and its employees believe this growth is directly attributable to the enhanced dedication and increased productivity of its employee-owners.

Employee ownership also serves to keep jobs and companies in the United States. Appleton, located in Appleton, Wisconsin, is the world's leading producer of carbonless paper and the largest U.S. producer of thermal paper. Following more than 20 years of foreign ownership, the U.S. employees of Appleton recently elected to purchase the company from its European parent and move $107 million of 401(k) investments into company stock. Wall Street rewarded the strength of this company with the additional financing Appleton required.

Employees benefit from owning private businesses

Millions of employees have amassed substantial retirement savings and retired early as a result of owning shares of their company. Employees want to own company stock in their retirement plans knowing that their hard work results in easily measurable cash benefits to them.

To give an example from Rieth-Riley Construction Company in Goshen, Indiana, one long-time employee participated in the company's profit sharing plan (the only plan offered at the time) for 17 years and accumulated a balance of $35,000. The plan was terminated and the balance rolled over into the company's new 401(k) plan, which grew to $195,000. The employee's first allocation to the ESOP was made in 1986. After participating in the ESOP for roughly the same period of time as he had in the 401(k), this employee's ESOP balance grew to over $500,000 with only "sweat equity" required from the employee. As a Rieth-Riley representative describes it, "this is the American dream of ownership without the risk of personal assets."

These companies, which create unique benefits, are also uniquely at risk in the context of pension reform

Two particular features distinguish private businesses from their public counterparts. First, the stock of a private business cannot be sold on the public market. When company stock is sold, *the only purchaser of the shares is the company itself.* Thus, any change to

current law that facilitates or mandates substantial sales of private company stock would place an enormous strain on the capital of the company-buyer, and could threaten the value of the stock itself – i.e., the holdings of the employees of the company.

If some of the proposals introduced in Congress last year were enacted, Scot Forge, a small, private open die and rolled ring forging manufacturing company in Illinois, would have to buy back almost 80% of its outstanding stock, a step that would require $88 million in cash the company does not have.

Many other private employee-owned companies would be forced to liquidate to allow eligible participants to sell company stock at any time. A private company facing an enormous repurchase obligation could not only be forced to reduce its voluntary savings plans/matches, but may in fact be forced to reduce its workforce or take other drastic measures to stay in business. These results are prohibitive to the idea of employee ownership.

The second related distinction between public and private companies is that a private company's stock value does not derive from the public markets, but rather from a private valuation of the company's assets, liabilities and cash flow. *Regardless of whether the employees choose to sell their shares*, any change to current law that facilitates the sale by employees of large amounts of private company stock creates a massive contingent liability for the company buyer. The automatic result of this liability is that the company's stock value will fall, *resulting in a devaluation of the employees' stock accounts*, thus harming the very savings Congress ostensibly is seeking to protect.

Conclusion

ESCA looks forward to continuing to work with the Committee to ensure that any pension reform legislation considered this year protects both America's private companies and the retirement savings of millions of American workers in these businesses. To meet this goal, the unique nature of private companies and the benefits they provide to their employees must be taken into account as pension legislation is considered. ESCA and its members, who operate in virtually every state in the nation, are thankful that the House Committee on the Education and the Workforce bill recognizes this distinction and works to preserve and promote employee ownership in private business.

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APPENDIX H – SUBMITTED FOR THE RECORD, STATEMENT OF AMERICAN COUNCIL OF LIFE INSURERS (ACLI)

STATEMENT OF THE

AMERICAN COUNCIL OF LIFE INSURERS

BEFORE

THE SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS

OF THE

COMMITTEE ON EDUCATION AND THE WORKFORCE

UNITED STATES HOUSE OF REPRESENTATIVES

ON

THE PENSION SECURITY ACT: NEW PENSION PROTECTIONS TO SAFEGUARD THE RETIREMENT SAVINGS OF AMERICAN WORKERS

THURSDAY, FEBRUARY 13, 2003

I. Introduction

The American Council of Life Insurers (ACLI) is the major trade association of the life insurance industry, representing more than 380 life insurance companies. ACLI member companies hold over 70% of all of the assets of U.S. life insurance companies.

ACLI applauds the subcommittee's continued interest in reviewing and modernizing the retirement security of America's workers. As part of that security Chairman Johnson and Chairman Boehner have expressed their intent to reintroduce the Pension Security Act. This measure passed the House last year with a strong bipartisan vote.

ACLI strongly supports this legislation. However, our statement is intended to focus on the provisions in that measure that would allow regulated financial institutions to offer investment advice to pension plan participants.

II. The Need for Investment Advice Legislation

In recent years, testimony before this subcommittee has identified several key reasons why investment advice legislation, as well as more comprehensive legislation, is needed.

First, since ERISA was adopted, retirement plans have steadily moved from traditional defined benefit plans towards defined contribution plans (e.g., 401(k) plans) and individual retirement accounts ("IRAs"). Now, more than $5 trillion is held in defined contribution plans and IRAs where employees make investment choices and assume investment risk. During this same time

period, there has been tremendous growth in the number of new investment options available to participants, including thousands of new mutual funds, new types of insurance arrangements and self-directed brokerage windows through which participants can invest in almost any debt or equity security. More and more, the retirement security of millions of Americans turns on how well they make investment decisions among a more varied and complex set of investment choices.

At the same time, ERISA's prohibited transaction rules – as interpreted and administered by the Department of Labor ("DOL") – have discouraged the delivery of individualized investment advice services to plan participants.[1] Under these rules, employers are concerned about providing investment advice themselves because they could assume fiduciary responsibility and liability for employee investment decisions. In contrast, the financial services firms that provide investment options and administrative services to employer plans are experienced and willing to provide advice services, but they are effectively barred from providing such services under ERISA's prohibited transaction rules.

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[1] Section 404 of ERISA sets forth broad fiduciary rules that are modeled on the common law of trusts. These provisions impose duties of loyalty, prudence and diversification on plan fiduciaries. However, section 406 of ERISA departs from the common law of trust and broadly bar certain "prohibited transactions," including transactions between employee benefit plans and "parties in interest," and conflict of interest transactions (e.g., self-dealing and kickbacks). Fiduciaries may be personally liable for violations of the fiduciary rules and may be sued for damages to make plans whole for investment losses caused by a fiduciary breach. A variety of other remedies are available for violations of sections 404 and 406, including injunctive relief and various civil and tax penalties.

Financial services firms have been largely blocked from providing specific investment advice to plan participants because the DOL has construed ERISA's prohibited transaction rules, which were adopted to prohibit self-dealing and kickbacks, to prohibit financial services firms giving specific investment recommendations on any investment options where the firm may receive an additional fee as a result of the participant's investment decision (e.g., receipt of advisory fees from the firm's proprietary mutual fund or the receipt of a 12b-1 fee from unaffiliated mutual funds).

Under DOL's approach, financial services firms must either avoid giving specific investment recommendations, or they are required to obtain individual exemptions from the DOL before advice services can be delivered. When financial services firms seek such exemptions, the DOL imposes significant "product design" conditions that regulate the types and amount of fees or require the use of independent third parties in developing asset allocation and advice programs.[2] Notably, DOL's recent exemption activity represents a departure from its approach in the 1970s and 1980s, when it issued a number of class exemptions from ERISA's conflict of interest rules for the sale of insurance products and securities that mainly conditioned relief on disclosure and consent by plan fiduciaries.

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[2] See PTE 97-12, 62 Fed. Reg. 7275 (Feb. 19, 1997) (Wells Fargo exemption requiring fee offsets); PTE 97-60, 62 Fed. Reg. 59744 (Nov. 4, 1997) (TCW requiring use of independent firm to prepare advisory services).

Because of DOL's recent approach to advisory programs, the only persons who can clearly provide specific investment advice under current law without obtaining a burdensome exemption are completely unaffiliated persons that have no established relationship with employers, plans and participants. Many of these vendors are start up companies that provide advisory services mainly over the internet. While there is clearly a role for such vendors, they alone will not close the "advice gap."

Employers and participants will benefit from being able to choose among advice services offered by both independent providers and full-service financial services firms. Financial services firms offer in-person or telephone advisory services through their networks of thousands of agents, brokers and advisers, in addition to internet services. In addition, as a practical matter, employers that sponsor plans may not make advice services available to plan participants if they are required to separately contract with someone other than the financial services firm that administers the 401(k) plan to provide advice. Larger employers generally want service providers with a nationwide capability that have an existing understanding of their plan and participants. Most employers want to use one service provider to facilitate the provision of investment options, handle recordkeeping and administrative services, as well as to coordinate the provision of investment advice and education. Under these arrangements, employers are able to access both affiliated and unaffiliated investment options through a single service provider, but they are unable to access advisory services from the same provider. Allowing the

financial services firm that makes available the employer's defined contribution plan to provide advice – rather than requiring the employer to separately arrange for such services by another firm – will result in more employers offering advisory services to plan participants and will likely lower plan costs for such services.

There have been additional developments that further highlight the need for Congress to enact the Pension Security Act.

First, the volatility in the investment markets actually serves to reinforce the need for participants to be able to access sound investment advice. Without proper advice and education, participants may be tempted to make short-term investment decisions based solely on the recent market activity. Financial advisers can educate participants on the need to take into account the appropriate time horizons for their investment decisions, the need for diversification, the relative volatility of equity versus debt investments, and the long term expected returns on different types of categories of investments. Most importantly, advisors can help participants choose among specific investment alternatives to develop a portfolio best suited for their needs. These services are even more critical in a volatile investment environment. Moreover, the provisions in the bill that permit participants to sell employer matching stock means these participants will need investment advice more than ever as they make decisions on whether to sell such stock and select other plan investment options or to hold such stock.

Finally, in June 2001 Congress passed and the President signed the "Economic Growth and Tax Relief Reconciliation Act of 2001." The tax bill includes many favorable changes to the tax rules that govern pension plans and IRAs. These proposals, authored on a bipartisan basis by Representatives Portman and Cardin, and cosponsored by many members of this committee, significantly increase the amount of contributions that can be made to all forms of defined contribution plans and IRAs. As a result, we can expect that participants will further increase the amount of retirement savings that flow into such retirement savings plans. In addition, the tax bill reflects Congress' recognition that workplace-based retirement planning is a vital component for educating participants about their retirement.[3] Providing investment advice is an essential component of retirement planning.

III. The Pension Security Act Protects Participants

ACLI believes that the Pension Security Act is both an effective, and safe, means to address the "advice gap." The bill creates a new statutory exemption from ERISA's prohibited transaction rules for "fiduciary advisers." If the many conditions of the advice exemption are met, then "fiduciary advisers" would be able to provide specific investment recommendations and receive fees that may vary somewhat based on the investment choices made by participants. However, the legislation includes the following crucial

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[3] The tax bill clarifies that employees will not be taxed on the fair market value of qualified retirement planning services provided by their employer. Code § 132(a)(7), (m).

protections that ensure that participants are protected from conflicts of interests:

- ERISA's fiduciary rules continue to apply to the provision of advice by the fiduciary-adviser. These rules require that fiduciary-advisers act prudently and solely in the interests of participants. Simply put, under these rules, it would be illegal for a fiduciary adviser to make specific investment recommendations for the purpose of increasing their (or their firm's) compensation. The adviser would be personally liable to make up any losses caused by a breach of fiduciary duty and would be subject to civil penalties.
- ERISA's fiduciary rules will continue to apply to the employer who selects the fiduciary adviser. Thus, the employer must act prudently and solely in the interest of participants in selecting and periodically monitoring the advisor. However, the bill does make clear that employers who fulfill these duties will not be liable for the specific advice given by the fiduciary adviser.
- The bill limits the provision of advice to "fiduciary advisers." Fiduciary-advisers are financial services firms that are comprehensively regulated under other federal or state securities, insurance or banking laws.
- The bill mandates the provision of significant disclosures before the fiduciary adviser may give any advice. Such disclosures will inform participants of any financial interest the fiduciary adviser may have, the nature of the adviser's affiliation (if any) with the available investment

options, and any limits that may be placed on the adviser's ability to provide advice. These types of disclosure obligations, along with fiduciary duties, have worked well in regulating the conduct of advisers under federal securities laws for more than 60 years. Similar disclosures have also worked well for existing DOL class exemptions that cover the purchase of insurance contracts and affiliated mutual funds.[4]

- The bill keeps participants in control of their investment decisions by requiring that investment decisions be made exclusively by plan participants – not the fiduciary adviser. The adviser may make recommendations to participants, but may not make discretionary investment decisions on behalf of participants.
- All transactions must be conducted on arm's length terms and for only reasonable compensation.

IV. Conclusion

ACLI strongly supports The Pension Security Act and we hope the bill is only the first important step by this subcommittee to modernize and update ERISA's fiduciary and prohibited transaction rules. The legislation strikes the right balance of allowing comprehensively-regulated financial services firms to provide specific investment advisory services, while at the same time carefully protecting the interests of plan participant. The result will be

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4 See PTE 84-24, 49 Fed. Reg. 13208 (April 3, 1984).

increased competition in the advisory services arena, which will improve such services, make them more widely available and lower costs.

Because the current bill strikes the right balance, ACLI believes that it is critical that the sponsors of the bill retain the basic framework of the bill as the bill moves through this committee and Congress. The sponsors of the bill should oppose efforts to narrow the scope of the bill to make it less flexible or to include the types of "product design" conditions and limitations that have encumbered advisory programs subject to DOL exemptions.

Again, we applaud this subcommittee's labors in the area of pension security and look forward to working with you as the legislative process progresses.

APPENDIX I – SUBMITTED FOR THE RECORD, STATEMENT OF THE INVESTMENT COMPANY INSTITUTE

STATEMENT
OF THE
INVESTMENT COMPANY INSTITUTE

ON THE PENSION SECURITY ACT: NEW PENSION PROTECTIONS TO SAFEGUARD THE RETIREMENT SAVINGS OF AMERICAN WORKERS

SUBMITTED TO THE SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS
COMMITTEE ON EDUCATION AND THE WORKFORCE
U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 13, 2003

The Investment Company Institute (the "Institute")[1] is pleased to submit this statement on pension security to the House Subcommittee on Employer-Employee Relations. The U.S. mutual fund industry serves the retirement savings and other long-term financial needs of millions of individuals. By permitting individuals to pool their savings in a diversified fund that is professionally managed, mutual funds play an important financial management role for American households.

Mutual funds also function as an important investment medium for employer-sponsored retirement programs, including section 401(k) plans, 403(b) arrangements and SIMPLE plans used by small employers, as well as for individual savings vehicles such as the traditional and Roth IRAs. As of December 31, 2001, about $2.3 trillion in retirement assets, including $1.2 trillion in IRAs and $1.1 trillion in employer-sponsored defined contribution plans, were invested in mutual funds.[2] In addition, the mutual fund industry provides a full range of administrative services to employer-sponsored plans, including trust, recordkeeping, and participant education services.

Retirement security is of vital importance to our nation's future. The Institute has long supported efforts to enhance retirement security for Americans, including efforts to encourage retirement savings through employer-sponsored plans and IRAs, simplify the rules applicable to retirement savings vehicles, and enable individuals to better understand and manage their retirement assets.

The Institute commends the efforts of the Subcommittee to enhance retirement security for all Americans. The critical reforms set forth in the Pension Security Act legislation being considered by this Subcommittee would advance this goal in a number of important respects.

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[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,935 open-end investment companies ("mutual funds"), 559 closed-end investment companies and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.382 trillion, accounting for approximately 95% of total industry assets, and over 90.2 million individual shareholders.

[2] *Mutual Funds and the Retirement Market in 2001*, Fundamentals, Vol. 11, No. 2, Investment Company Institute (June 2002). These figures represented about 49 percent of all IRA assets and 44 percent of all 401(k) plan assets.

As discussed in greater detail below, the Pension Security Act would expand participant access to professional investment advice that is subject to uncompromising legal standards and designed solely to help them achieve their savings goals. As a result, individuals would have available to them the tools they need to appropriately invest their retirement assets. The Pension Security Act also would enhance disclosures provided to participants about their plan accounts, as well as expand diversification rights with regard to employer securities. We urge Congress to swiftly enact these and other important reforms fundamental to retirement security.

I. Investment Advice For Retirement Plan Participants

The need for professional investment advice among retirement plan participants is particularly acute. Because participants in self-directed retirement plans like the 401(k) are responsible for directing their own investments, it is critical that they have access to information, education and advice that will enable them to prudently invest and diversify their retirement savings. Reforms in this area reflected in the Pension Security Act will help equip participants to appropriately invest their retirement assets, while imposing stringent participant protections that would require investment advisers to act solely in the interests of participants and beneficiaries.[3]

A. Current Law Restricts the Delivery of Advisory Services

Many retirement plan participants who direct their own account investments seek investment advice when selecting investments in their plans. Today's pension laws, however, significantly and unnecessarily limit the availability of investment advice. Indeed, ERISA severely limits participants' access to advice from the very institutions with the most relevant expertise and with whom participants are most familiar. As a result, many 401(k) participants are unable to obtain investment advisory services through their retirement plans. Clearly, existing rules have stifled access to professional investment advice — to the detriment of plan participants.

The reason that many retirement plan participants do not have access to investment advice is that ERISA's prohibited transaction rules prohibit participants from receiving advice from the financial institution managing their plan's investment options. This is often the same institution that is already providing educational services to participants.[4]

Under ERISA, persons who provide investment advice cannot do so with respect to investment options for which they or an affiliate provide investment management services or from which they otherwise receive compensation.[5] The restriction applies even if the adviser

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[3] *See* section 404 of ERISA, which sets forth the stringent duties of ERISA fiduciaries.

[4] Current Department of Labor guidance permits plan service providers to provide "educational" services, but not actual "investment advice" without violating the *per se* prohibited transaction rules of ERISA. *See* Interpretative Bulletin 96-1, in which the Department of Labor specified activities that constitute the provision of investment "education" rather than "advice."

[5] *See generally* section 406 of ERISA for the prohibited transaction rules.

assumes the strict fiduciary obligations under ERISA — which, among other things, require them to act "solely in the interest of participants and beneficiaries" — and even if an employer selects the investment adviser and monitors the advisory services in accordance with its own fiduciary obligations. Indeed, the *per se* prohibition applies no matter how prudent and appropriate the advice, how objective the investment methodology used, or how much disclosure is provided to participants.[6]

Because of current legal constraints, the investment advisory services available to plan participants have largely been limited to "third-party" advice providers. Notwithstanding the presence of these third-party advice providers, however, relatively few 401(k) plan participants have investment advisory services available to them through their retirement plans. The Department's advisory opinion issued to SunAmerica[7] on the provision of advice did little to rectify this problem. The ruling essentially reiterates preexisting restrictions on the provision of investment advice to plan participants — restrictions that limit participants to third-party advice providers. Indeed, in a statement issued contemporaneously with the advisory opinion, Assistant Secretary of Labor Ann Combs expressed strong support for legislative reform consistent with the investment advice provisions of the Pension Security Act. Clearly, the availability of advice from third-party providers has *not* sufficiently addressed participants' needs.

B. The Pension Security Act

Recognizing this important public policy concern, the House of Representatives passed legislation to expand the availability of advice on multiple occasions — most recently as part of last year's Pension Security Act of 2002 (H.R. 3762).

The Pension Security Act would expand and enhance the investment advisory services available to participants. In particular, the legislation would allow advice to be obtained from the institutions most likely to be looked to for such services by participants and employers -- the financial institutions already providing investment options to their plans. Participants, therefore, would be able to receive advisory services from their plans' providers as well as third-party advice providers. Similarly, employers would be permitted to arrange for investment advice through a provider with which they are familiar, thereby eliminating the costs and burdens associated with selecting a separate vendor.

This legislation would enable pension plan participants to access sound investment advice from qualified financial institutions already known to them, while maintaining strict

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[6] Although the Department of Labor is authorized to provide exemptive relief from these rules, the limited exemptions issued by the Department to certain financial institutions have proven to be wholly inadequate, as they have included conditions that severely limit the ability of these firms to provide advisory services to plan participants. For example, under one approach adopted by the Department, advice may be provided if the institution agrees to a "leveling of fees" it or an affiliate receives from each investment option in the 401(k) plan. This makes little economic sense, however, because advisory fees for various investment options may differ widely from one fund to another, given that the underlying costs differ for each, depending on the type of investments the fund is making.

[7] Department of Labor Advisory Opinion 2001-09A.

requirements to assure that they are protected from imprudent and self-interested actors. These requirements include subjecting advice providers to strict fiduciary standards under ERISA and extensive disclosures of any potential conflicts of interest to participants.

First, only specifically identified, qualified entities already largely regulated under federal or state laws would qualify as "fiduciary advisers" permitted to deliver advice to participants under the bill.

Second, such advisers would have to assume fiduciary status under the stringent standards for fiduciary conduct set forth in ERISA. This, among other things, would require advisers to act solely in the interests of plan participants and beneficiaries, shielding them from imprudent or self-interested advice.

Third, employers, in their capacities as plan fiduciaries, would be responsible for prudently selecting and periodically reviewing any advice provider they choose to make available to their plan participants. Thus, participants would be afforded an additional layer of protection by virtue of the employer's responsibilities as a plan fiduciary.

Fourth, the legislation would establish an extensive disclosure regime. Specifically, the "fiduciary adviser" would have to provide timely, clear and conspicuous disclosures to participants that identify any potential conflicts of interest, including any compensation the fiduciary adviser or any of its affiliates would receive in connection with the provision of advice. Additionally, any disclosures required under the securities laws, which apply to similar advice provided outside of the retirement plan context, also must be provided to participants. It is important to note that these disclosure requirements are but one part of the broad panoply of investor protections.

Fifth, any advice provided could be implemented only at the direction of the advice recipient. Participants, therefore, would be free to reject any advice for any reason.

Finally, plan participants would have legal recourse available if a fiduciary adviser violates the standards set forth in the bill or ERISA. For instance, under section 502 of ERISA, a plan or participant could seek relief in federal district court to redress the adviser's violation of its fiduciary duties. Similarly, the Department of Labor has authority under ERISA section 502 to file suit against a fiduciary adviser in violation of ERISA and take regulatory enforcement action, including the assessment of civil penalties for any breach of fiduciary duty.

In short, there is little question that many plan participants seek and are in need of professional advice. The Pension Security Act would greatly expand the availability of these advisory services, while maintaining rigorous protections against parties that fail to serve participants' interests.[8]

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[8] The participant-protective safeguards and the overall approach of the Pension Security Act stand in stark contrast to an alternative proposal set forth in last year's Senate bill, the "Independent Investment Advice Act." That bill would not have expanded the types of advisers that may provide investment advice to participants; rather, it would only have provided fiduciary relief to employers when selecting and monitoring an investment adviser to provide advice to participants. Under that bill, participants largely would be limited to the advisory services of third party advice

II. Other Retirement Security Initiatives

In addition to meeting participants' need for professional investment advice, the Pension Security Act would require enhanced disclosures to be delivered to workers about their retirement plans. Quarterly statements containing the value of plan investments and a prominent reminder about the benefits of diversification would help participants better assess their retirement savings portfolio and modify their investment strategy appropriately.

The Pension Security Act also would provide greater diversification rights to participants with retirement assets invested in employer securities. By allowing workers to divest out of company stock in a much shorter period of time, the legislation would enable participants to minimize the risk of large losses in non-diversified investments — losses that could impair the ability to save adequately for retirement.

We therefore recommend that Congress enact these important reforms addressed by the Pension Security Act.

Finally, we recognize that efforts to enhance the retirement security of our workforce also must include initiatives to create savings opportunities for all Americans. Toward this end, the Administration has proposed the creation of Retirement Savings Accounts, Lifetime Savings Accounts and Employer Retirement Savings Accounts — three new retirement and savings vehicles that will both enhance the ability of Americans to save for their future and simplify the current rules governing retirement plans. The Institute strongly supports savings and simplification initiatives that would bring long-term savings and investment opportunities within the reach of every working American.

III. Conclusion

Empowering individuals with professional investment advice, enhanced disclosures and greater diversification rights, as well as stronger savings incentives, would promote greater retirement security for all Americans. We urge swift enactment of such reforms.

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providers already allowed under current law — which, as noted above, effectively has restricted the availability of investment advice to a small percentage of participants.

APPENDIX J – SUBMITTED FOR THE RECORD, EMPLOYEE OPINIONS ON RETIREMENT PLANS: A BENCHMARK STUDY ON RETIREMENT PERCEPTIONS, THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, FLORHAM PARK, NJ

EMPLOYEE OPINIONS ON RETIREMENT PLANS:

A Benchmark Study on Retirement Perceptions

Prudential Financial

Prudential Financial

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Winter, 2003

Prudential Financial believes every American worker deserves a financially secure retirement. Our mission is to help workers achieve their retirement dreams. As we know today, it has become more difficult for many to reach their financial goals and live comfortably in retirement. Even more distressing, currently too many American workers are guessing when it comes to estimating how much they need to save for retirement.

To better understand American workers' views on saving for retirement, Prudential Financial has conducted a research study called the *2002 Employee Opinions on Retirement Plans: A Benchmark Study on Retirement Perceptions*. The nationwide survey of 1,064 American workers between the ages of 21 and 65 gauged how Americans are doing when it comes to saving for their golden years. In particular, we wanted to ascertain their confidence in and knowledge of:

- Planning and setting goals
- Participating in defined contribution plans
- Deferrals into their retirement plans
- Asset Allocation and Distribution Planning
- Guidance and Advice.

The survey confirmed American workers are having difficulty planning for retirement due to a variety of reasons. The key findings show:

- Although about half of workers say they know how much they need for retirement, many admit the estimate was a guess.
- Many workers acknowledge they aren't saving enough.
- Workers are very receptive to advice—not just investment advice—but guidance on saving enough.

Here at Prudential Financial, we remain committed through our various business efforts to helping American workers save more and plan for a secure retirement. We would like to share the full results of our *2002 Employee Opinions on Retirement Plans: A Benchmark Study on Retirement Perceptions* (enclosed) for your reference. I think you will find the survey very insightful and useful.

Sincerely,

Scott Sleyster
President
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Prudential Financial 2002 Retirement Perceptions Study Executive Summary

Prudential Financial wants every American worker to enjoy a financially secure retirement. Our goal is to help workers achieve their retirement dreams. Recently, Prudential conducted a research study titled the *2002 Employee Opinions on Retirement Plans: A Benchmark Study on Retirement Perceptions*. It surveyed 1,064 American workers between the ages of 21 and 65 to develop a clearer picture of how Americans are doing when it comes to saving for their golden years. The study found that Americans lack the confidence and knowledge they need for successful retirement planning.

Retirement Plan Participation and Social Security

American workers acknowledge that Social Security won't provide enough income in retirement. Nearly half (47 percent) of retirement plan participants think that Social Security may no longer exist by the time they retire.

Of those respondents who do participate in their employer/union sponsored retirement plans:

- One-third (33 percent) participate mainly because they don't think Social Security alone will provide enough income to retire comfortably.
- 24 percent cited employer match as the most important factor that impacted their decision to join. 15 percent of those age 50-65 indicated tax advantages as a main reason. 15 percent of younger participants (those age 21-34) credited the convenience of contributing through payroll deduction.

Of those respondents who do not participate in their employer/union sponsored retirement plan:

- Those who have yet to join their employer/union sponsored retirement plans are among the most vulnerable and in need of help. Non-participants surveyed tend to have lower incomes, and yet half are married with children.
- One third (33 percent) of those age 35-49 said they can't afford to contribute.
- Employers can help. 68 percent said they'd be strongly influenced to join an employer/union sponsored retirement plan if it offered a dollar-for-dollar match.
- Advice and personalized communications can boost participation. 45 percent of respondents age 35-49 would participate if given access to a financial advisor who can provide guidance on where and how much to invest. 40 percent of those age 21-34 would be influenced to join if their employer provided them with a personalized projection based on their age and salary that suggested a retirement savings goal, how much they need to save, and how to start investing.

Successful Retirement Planning Starts with Setting Informed Goals

However, many American workers may have underestimated their retirement savings needs, and too many are still guessing how much money they will need for retirement and admit they are not saving enough.

Only a slight majority of respondents (52 percent) say they have a good idea how much money they will need in retirement. When asked how they arrived at the estimate of what they will need in retirement, 30 percent said they gave it their best guess, 29 percent said a professional advisor did the calculation for them, 17 percent used a paper questionnaire, and 12 percent used an Internet tool or computer program.

(continued...)

Among respondents who say they have a good idea of how much they'll need to save, 30 percent said they need between $100K-$499K, 29 percent said between $500K-$999K, and 28 percent said $1 million or more. The majority of all respondents (57 percent) acknowledged they are not saving as much as they should for retirement.

Underscoring the need for even the most basic form of advice, an overwhelming majority (91 percent) agreed a personalized projection of how much money they need to save—taking into account their age and income—would be reliable and helpful.

Hoping for Comfortable Retirement
Securing a comfortable retirement is a part of everyone's American dream. While American workers admit they aren't saving enough, they still have high expectations about their standard of living in retirement.

The vast majority (85 percent) of all respondents realistically expect their standard of living to remain the same or get better in retirement.

This is particularly true for younger American workers. Forty percent of workers between 21 and 34 years of age expect their standard of living in retirement to be better than it is now, compared to 21 percent of 35-49 year-olds and just 14 percent of 50-65 year-olds.

Distribution Indecision
When asked about what to do with their accumulated retirement savings when changing jobs, American workers had a good idea of their options and had a plan—38 percent would roll them over into a new plan, 34 percent into an IRA, and 22 percent would keep the assets in the original plan.

But when asked about what to do with their savings at retirement, more than one in five (21 percent) participants between ages 50 and 65, who are close to retirement, said they did not know which option to choose.

Advice Wanted
The majority (57 percent) of current defined contribution participants say they would be very or somewhat likely to use financial advice provided by their employer or union to change what they are currently doing in their retirement plan.

A strong majority (63 percent) of participants say that if they had access to a professional investment advisor who could help with their retirement planning, they would invest more if they could afford to, based on this person's advice; 41 percent would reallocate their portfolio based on this person's advice.

Retirement Dreams
Prudential Financial's *2002 Employee Opinions on Retirement Plans: A Benchmark Study on Retirement Perceptions* results clearly demonstrate the need for American workers to have guidance and advice. Prudential Financial is committed to educating and guiding American workers towards a secure retirement. We are continually developing programs that address many of the issues raised in our survey to be sure we meet the needs of every generation of American workers.

Methodology and Sample Characteristics

Zeldis Research Associates conducted a nationwide, random digit dialing national phone survey of 1,064 Americans, ages 21-65, who have worked full-time for the same employer for at least the past year and whose employer/union provides a defined contribution retirement plan, such as a 401(k). Nine hundred respondents are currently participating in their employer's defined contribution retirement plan; 164 are not participating.

At a 95 percent confidence interval, the margin of error for the entire participant population is plus or minus 3.3 percent; the margin of error for the non-participants is plus or minus 7.7 percent; the margin of error for the combined population of participants and non-participants is 3.0 percent.

SAMPLE CHARACTERISTICS	FREQUENCY	PERCENT OF TOTAL
Sample Size	1,064	100
Participants	900	85
Non-Participants	164	15
AGE		
21-34	331	31
35-49	410	39
50-65	323	30
Did not answer age	37	3
PLAN TYPE		
401(k)	838	79
403(b)	66	6
Union-negotiated annuity plan	55	5
457	14	1
GENDER		
Male	513	48
Female	551	52

(continued...)

SAMPLE CHARACTERISTICS	FREQUENCY	PERCENT OF TOTAL
EDUCATION		
Less than high school degree	20	2
High school degree	188	18
Technical or trade school degree	52	5
Some college	183	17
2-year college degree	112	11
4-year college degree	185	17
College degree	114	11
Graduate degree	194	18
Did not answer education	16	2
ANNUAL HOUSEHOLD INCOME		
Less than $25,000	35	3
$25,000-$49,999	237	22
$50,000-$74,999	261	25
$75,000-$99,999	182	17
$100,000-$149,999	127	12
Above $150,000	75	7
Did not answer income	147	14

Survey Results

1. Which of the following statements best describes the main reason you participate in your employer's retirement plan?
[Participants (n=900)]

Social Security is insufficient	**33%**
Employer match	**24%**
Easy to build wealth	**15%**
Tax advantages	**10%**
Easy to contribute	**9%**
Can't save enough without it	**5%**
Portability	**2%**
DK/Refused	**2%**

American workers acknowledge that Social Security won't provide enough to live on in retirement. The main reason participants say they participate in their employer/union sponsored retirement plan is they don't think Social Security alone will give them what they need to retire comfortably. One-third of participants, when asked to cite the main reason they were participating, chose this one. The next most-often cited reason is the employer match, which was noted by 24 percent of participants.

2. Please tell me how strongly you agree or disagree with each of the following statements on why you might not be participating in your employer's retirement plan.
[Non-participants (n=164)]

For non-participants ages 35-49, one-third (33 percent) said they don't participate because they can't afford to contribute. This is significantly higher than participants ages 21-34 (18 percent) and 50-65 (19 percent). More than one-third (36 percent) of female participants also cited this a main reason they don't participate.

	TOTAL % WHO STRONGLY AGREE	AGE 21-34	AGE 35-49	AGE 50-65
Employer provides pension apart from 401(k)	**35%**	**25%**	**33%**	**51%**
Have other investments	**32%**	**25%**	**25%**	**51%**
Can't afford to contribute	**24%**	**18%**	**33%**	**19%**
Money needs to be accessible; putting it in plan would tie it up	**22%**	**19%**	**25%**	**21%**
Economy too uncertain	**22%**	**16%**	**27%**	**23%**
Haven't thought about contributing	**16%**	**18%**	**10%**	**23%**
I don't trust 401(k) plan employer provides	**14%**	**9%**	**15%**	**19%**
Spouse contributes to 401(k), so I don't have to	**13%**	**14%**	**12%**	**15%**
Retirement will work itself out	**7%**	**11%**	**3%**	**6%**
Employer's plan confuses me	**5%**	**7%**	**5%**	**4%**
I'm too young	**4%**	**4%**	**3%**	**4%**
I'm too old	**2%**	**2%**	**2%**	**4%**

(continued...)

3. Please tell me how strongly influenced you would be by the following steps your employer/union might take to influence you to participate in its retirement plan.
[Non-participants (n=164)]

	TOTAL % WHO WOULD BE INFLUENCED	AGE 21-34	AGE 35-49	AGE 50-65
Employer/union contributed one dollar to your retirement plan for every dollar you contribute	84%	88%	88%	74%
Your employer/union contributed 50 cents to your retirement plan for every dollar you contribute	74%	81%	73%	68%
Your employer gave you a raise	71%	81%	77%	53%
Your employer created a personalized plan that suggested a retirement goal, how much you need to save now, and how to start investing	71%	84%	70%	55%
Your employer gave you access to an advisor who would provide you with specific advice on how to enroll and where to put your money	68%	72%	72%	60%
You knew you could borrow against the money in your retirement plan	63%	77%	63%	45%

Non-participants of all ages would be strongly influenced to participate in their employer/union sponsored retirement plan if their employer/union offered a dollar-for-dollar match (84 percent). Non-participants would also be influenced to join their employer/union sponsored retirement plan if their employer/union provided them with a personalized plan based on their age and salary that suggested a retirement goal, how much they need to save now and how to start investing (71 percent).

A high percentage of non-participants ages 35-49 also strongly agree that they would be influenced to participate if they received a raise (77 percent) or if their employer/union gave them access to a financial advisor that would provide them with specific advice on how to enroll and where to invest (72 percent).

(continued...)

4. Do you have a good idea how much money you'll need in retirement? *[Participants & Non-Participants (n=(1,064)]*

Yes	**52**
No	**45**
DK/Refuse	**3**

Only a slight majority of respondents (52 percent) say they have a good idea how money they will need in retirement. The percentages are only slightly higher for defined contribution participants (53 percent) vs. non-participants (49 percent).

5. Approximately how much do you think you will need for retirement?
[Participants & Non-Participants who have a good idea of how much money they'll need to have to live comfortably in retirement (n=554)]

<$100K	**7%**
$100K-$499K	**30%**
$500K-$999K	**29%**
>$1 million	**28%**
DK/Refused	**6%**

Respondents that do have a good idea were generally split into three groups when asked how much they think they will need for retirement: 30 percent said between $100K-$499K, 29 percent said between $500K-$999K, and 28 percent said $1 million or more.

6. How did you come up with this amount?
[Participants & Non-Participants who gave a dollar amount (n=521)]

I gave it my best guess	**30%**
A professional advisor did this calculation for me	**29%**
I used a paper questionnaire and calculated the numbers myself	**17%**
I used an Internet tool or computer program	**12%**
I read it somewhere	**6%**
Someone else did this calculation for me	**6%**
DK/Refused	**0%**

American workers are still guessing when it comes to retirement. Although a small majority of respondents (participants and non-participants) say they have a good idea how much money they will need in retirement, when asked how they arrived at the estimate of what they will need in retirement, 30 percent said they gave it their best guess. The numbers were higher for non-participants (36 percent) vs. participants (28 percent), with non-participants age 35-49 having the highest percentage (46 percent).

7. Do you think you are currently saving enough for retirement?
[Participants (n=900) Non-Participants (n=164)]

Yes	**42%**
No	**57%**
DK/Refused	**2%**

The majority of all respondents (57 percent) do not think they are saving as much as they should for retirement. This is particularly true among non-participants, 72 percent of whom say they are not saving enough for retirement. A majority (54 percent) of participants also do not think they are saving enough.

8. On a periodic basis, you receive a statement about your retirement plan. If this statement told you, based on your salary and age, how much you actually need to set aside each pay period to increase your chances of reaching your retirement goal, would you consider that information to be...
[Participants (n=900)]

Reliable	**91%**
Not reliable	**7%**
Don't know/refused	**2%**

Survey respondents (91 percent) agreed a personalized projection statement of how much money they need to save for retirement—taking into account their age and income—would be a reliable way to calculate the amount they need to set aside to reach their retirement goal.

(continued...)

9. What standard of living do you realistically expect to have in retirement?
[Participants (n=900) Non-Participants (n=164)]

American workers have high expectations about their standard of living in retirement. A high majority (85 percent) of respondents expect their standard of living to remain the same or get better in retirement. This is particularly true for younger American workers. A majority (51 percent) of non-participants ages 21-34 say their standard of living in retirement will be better than it is now, while 86 percent of participants and 77 percent non-participants ages 35-49 think that they will live at or above their current standard of living when they reach retirement. Only a small percentage of participants (12 percent) and non-participants (19 percent) ages 50-65 think their standard of living will improve.

	PARTICIPANTS				NON-PARTICIPANTS		
	TOTAL	AGE 21-34	AGE 35-49	AGE 50-65	AGE 21-34	AGE 35-49	AGE 50-65
Much better than now	7	12	6	1	12	10	4
Somewhat better than now	18	26	15	11	39	15	15
About the same as now	60	53	65	67	37	52	70
Somewhat worse than now	12	8	11	18	11	17	11
Much worse than now	2	0	3	1	0	7	0
DK/Refused	1	1	1	1	2	0	0

10. How do you plan to handle your retirement plan money when you retire?
[Participants (n=456)]

	TOTAL	AGE 21-34	AGE 35-49	AGE 50-65
Leave money in plan	32%	25%	37%	33%
Roll over into IRA	31%	32%	27%	35%
Purchase annuity	9%	8%	10%	8%
Take all in cash	6%	9%	5%	3%
DK/Refused	23%	26%	21%	21%

American workers are unsure about what to do with their money in retirement. Seventy-two percent of participants do not intend to "take the money and run," but rather they plan to keep the money invested somehow. Thirty-two percent of participants said they would leave the money in their current plan and 31 percent said they would roll it into an IRA.

Most disturbing, however, 23 percent said that they either did not know what to do with the money, or refused to answer the question. Only 9 percent of participants plan to purchase an annuity. Just 6 percent of participants plan to take it all in cash. Despite their proximity to retirement, one-fifth of respondents ages 50-65 don't know or refused to say how they plan to handle their retirement money.

Men were likelier than women to say they would leave money in the plan (35 percent vs. 29 percent) or roll it over into an IRA (33 percent vs. 29 percent). Women were much likelier to not know the answer to the question or refuse to answer (27 percent) vs. men (18 percent).

11. How do you plan to handle your retirement plan money when change jobs?
[Participants (n=458)]

	TOTAL	AGE 21-34	AGE 35-49	AGE 50-65
Roll it into your new employer's plan	38%	47%	42%	25%
Roll over into IRA	34%	33%	37%	30%
Leave the money in the plan	22%	15%	15%	38%
Take all in cash	2%	2%	3%	1%
DK/Refused	4%	4%	3%	6%

Participants have a much clearer sense of what they would do with their money if they were to change jobs as opposed to retiring and leaving the work

(continued...)

force entirely. Thirty-eight percent said they would roll their money into their new employer's plan, 34 percent said they would roll it into an IRA, 22 percent would leave the money in their existing plan, and 2 percent would take it all in cash. Only 4 percent do not know (or refuse to say) what they would do in this situation.

There's a considerable difference in attitudes towards retirement money and job changing across the age spectrum. Nearly half (47 percent) of younger workers (ages 21-34), and 42 percent of middle-aged workers (ages 35-49), would roll their money into their new employer's plan. But only 25 percent of older workers (50-65) would do that.

Instead, 38 percent of older workers who changed jobs said they would leave their money with their existing employer's plan, as opposed to only 15 percent of both younger age groups who said they would keep their money where it was.

12. Do you think that borrowing against your retirement plan to buy a new home, pay for college, or manage a major expense is...? *[Participants (n=468)]*

a) Always a good idea and would definitely do it
b) Sometimes a good idea and you would consider it
c) Sometimes a bad idea but you might do it under certain circumstances
d) Always a bad idea and you would never do it
e) Don't know refused

	TOTAL	21-34	35-49	50-65
Always a good idea	5%	6%	4%	5%
Sometimes a good idea	21%	22%	22%	17%
Sometimes a bad idea	41%	46%	43%	35%
Always a bad idea	32%	26%	30%	41%
Good total	26%	28%	27%	22%
Bad total	74%	72%	73%	76%
DK/Refused	1%	0%	0%	2%

Participants acknowledge that borrowing against their defined contribution plans is not a good idea. Only 5 percent of participants said it is always a good idea to borrow against their retirement plan, while 21 percent said it was sometimes a good idea and they would consider it. Nearly one-third (32 percent) said it is always a bad idea and would never do it; 41 percent, a plurality, said it is sometimes a bad idea but might do it under certain circumstances.

Participants ages 21-34 were somewhat less willing to condemn borrowing as a universally bad idea, compared to older groups. For example, only 26 percent of this age group said that borrowing was always a bad idea, vs. 41 percent of those 50-65.

And according to Hewitt Associates' *How Well are Employees Saving and Investing in 401(k) Plans, 2001 Hewitt Universe Benchmarks*, of nearly 400,000 plan participants, nearly 30 percent had loans outstanding in 1999, with an average principle outstanding amount per participant of $6,900. The research also shows that nearly 30 percent of 40-49 year olds—the highest percentage of all ages—had loans outstanding.

13. Who do you turn to for investment advice? *[Participants & Non-Participants (n=1,064)]*

Financial professional	67%
Books, newspapers, magazines	61%
Education provided by employer: newsletters or seminars	59%
Friend or family member	55%
Informational websites	42%
Colleague or boss at work	35%
Financial planning software or tools	25%
None of the above/DK	3%

For the majority of survey respondents, a financial professional is the source more of them turn to for investment advice for retirement planning than any other. Sixty-seven percent of participants and 70 percent of non-participants say they use a financial professional.

(continued...)

14. Which one of the sources do you trust the most? *[Participants & Non-Participants (n=513)]*

Financial professional	**38%**
Friend or family member	**21%**
Books, newspapers, magazines	**13%**
Education provided by employer: newsletters or seminars	**7%**
Informational websites	**5%**
Colleague or boss at work	**4%**
Financial planning software or tools	**1%**
Don't turn to anyone	**10%**

When asked which source of financial advice participants and non-participants trust most, 37 percent of participants and 44 percent of non-participants chose a financial professional. However, when asked which source of financial advice they used most often, only 28 percent and 25 percent respectively use a financial professional. For non-participants, the source of financial advice they turn to most often are friends and family members (36 percent) even though only 22 percent trust this source the most.

15. How likely would you be (very likely, somewhat likely, not too likely, not at all likely) to use financial advice provided by your employer/union to change what you are currently doing in your retirement plan? *[Participants (n=900)]*

Very likely	**8%**
Somewhat likely	**49%**
Not too likely	**23%**
Not at all likely	**18%**
DK/Refused	**2%**

A majority (57 percent) of current participants say they would be very or somewhat likely to use financial advice provide by their employer or union to change what they are currently doing in their retirement plan.

Women seem more receptive to financial advice then men. By a margin of 62 percent to 53 percent, women are very or somewhat likely to use financial advice to change what they are doing.

16. If you had access to a professional investment advisor who could help you with your retirement planning, would you invest more if you could afford to based on this person's advice? *[Participants (n=444)]*

	TOTAL	21-34	35-49	50-65
Yes	**63%**	**72%**	**64%**	**52%**
No	**32%**	**23%**	**32%**	**41%**
Don't know/Refused	**5%**	**6%**	**4%**	**7%**

A strong majority (63 percent) of participants say that if they had access to a professional investment advisor who could help with their retirement planning, they would invest more if they could afford to based on this person's advice. Young adults were the most receptive of all age groups to investing more based upon professional advice (72 percent would). This compares to 64 percent of 35-49 year olds and 52 percent of 50-65 year olds. Lower income participants were likelier to favor investing more money based upon professional advice; 77 percent of those with incomes below $50,000 favored it, as compared with 56 percent in the highest income category. Women would also invest more (67 percent) than men (58 percent).

17. If you had access to a professional investment advisor who could help you with your retirement planning, would you reallocate your portfolio based on this person's advice? *[Participants (n=456)]*

	TOTAL	21-34	35-49	50-65
Yes	**41%**	**45%**	**41%**	**36%**
No	**49%**	**43%**	**47%**	**56%**
Don't know/Refused	**10%**	**12%**	**11%**	**7%**

Participants (41 percent) are much less likely to reallocate their portfolio based on the advice from a professional investment advisor than they are to invest new money if they could afford to. Young adults were the only age group where at least a plurality (45 percent) was receptive to reallocating based upon professional advice. The majority (56 percent) of 50-65 year olds opposed reallocation. Again, more women (44 percent) then men (38 percent) would reallocate their portfolio based on professional advice.

(continued...)

18. A proposal is currently being considered in Washington to require/allow workers to take a portion of the amount they currently pay in Social Security taxes and instead invest it in a personal retirement account. This money could not be touched until retirement. Are you in favor of this proposal? *[Participants and non-participants (n=581)]*

This question was asked two ways. In one way, respondents were asked to evaluate a proposal to require workers to put a portion of their current Social Security taxes into a personal account. Another way, respondents were asked to evaluate a proposal to allow workers to put a portion of their current Social Security taxes into a personal account. Surprisingly, the differences in wording caused only the most minor differences in outcome: there was very strong support for personal accounts either way.

Among respondents, 71 percent favor requiring and 72 percent favor allowing workers to put a portion of their Social Security tax money into a personal retirement account that could not be touched until retirement.

REQUIRE PERSONAL ACCOUNTS	
Yes	**71%**
No	**22%**
DK/Refused	**7%**

ALLOW PERSONAL ACCOUNTS	
Yes	**72%**
No	**21%**
DK/Refused	**6%**

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