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OVERSIGHT OF PENSION ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

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OVERSIGHT OF PENSION ISSUES

TUESDAY, MAY 5, 1998

HOUSE OF REPRESENTATIVES,
HOUSE WAYS AND MEANS COMMITTEE,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC

The Subcommittee met, pursuant to notice, at 2:07 p.m., in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
April 28, 1998
No. OV-16

CONTACT: (202) 225-7601

Johnson Announces Hearing on Oversight of Pension Issues

Congresswoman Nancy L. Johnson (R-CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a second hearing on oversight of various pension issues. **The hearing will take place on Tuesday, May 5, 1998, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include representatives from organizations interested in pension coverage issues, spokespersons for small business, and sponsors of pension plans. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The private-pension system is a key element in the retirement security for many Americans. Private pensions, along with Social Security and individual savings, are the three traditional components of an individual's retirement income. For example, in 1993, 67 million workers (57 percent of all workers) worked for an employer that sponsored a retirement plan. In 1995, the Social Security system covered nearly 140.9 million employees and self-employed persons.

The tax law historically has sought to encourage the growth of private pension plans by providing favorable tax treatment to them. For example, the Revenue Act of 1921 exempted from taxation the interest income earned by certain profit-sharing plans. Since then, the tax law has evolved into a complex array of provisions designed both to encourage employers to establish private pension plans, as well as to influence their content and features. The structure of the current pension tax law attempts to balance competing objectives. The policy of encouraging the establishment of pension plans often is tempered by provisions to limit manipulation that might unduly benefit a few highly paid employees.

The tax law contains limitations on how much of a person's salary may be taken into account for the purpose of calculating contributions to a pension plan for that person. The contribution limitations (the lesser of $30,000 or 25 percent of compensation) are based on a policy judgement that tax-favored pension plans should not unduly benefit senior executives. In a similar vein, the tax law restricts the operation of "top-heavy" pension plans with respect to "key" employees, which can include a person earning $65,000 per year. The tax law also imposes requirements regarding pension plan coverage and nondiscrimination rules. The nondiscrimination rules apply a set of mechanical rules to curb the operation of a plan to unduly benefit a small number of well-paid executives.

Pension tax law also affects pension beneficiaries. For example, elsewhere the pension tax law restricts the ability of workers to receive an immediate distribution of their pension account when their employer ceases its ownership of the business because of a buyout or merger. This is known as the "same-desk" rule.

(MORE)

The changing nature of the American workforce also has an effect on those covered and not covered by the current pension system. In 1950, 12 percent of women with children under age six were in the labor force, compared with 64 percent in 1995. The traditional pension plan provides the most favorable benefits to persons who remain in the workforce on a continuous basis. Interruptions in the work pattern because of child-rearing priorities, can result in a disproportionate reduction in the benefits which the care-giving parent eventually receives from the pension plan.

In announcing the hearing, Chairman Johnson stated: "Our private-pension system provides the retirement security for over 100 million workers and their families. A strong pension system allows people to retire in comfort and pursue their dreams by supplementing Social Security and personal savings. But overly complex tax rules may be stifling the growth of healthy pension plans. I want to explore current pension tax law to see whether Congress should prune the law in order to make the system stronger and to reduce the unfair effect it can have on women who interrupt their careers to raise a family."

FOCUS OF THE HEARING:

The Subcommittee will review current law to identify ways to simplify the pension tax law and to spur the growth of pension plans. The likely subject matter for review includes: (1) the limitation on the contributions to pension plans based on the salary of individual plan participants, (2) modifications to the "top-heavy" rules to better target their application to senior executives, (3) proposals for more flexible ways of satisfying the nondiscrimination rules, (4) proposals for a "catch-up contribution" to benefit persons who may not have a continuous work history, (5) the treatment of reinvested Employee Stock Ownership Plan dividends, (6) the "same-desk" rule which generally restricts a participant's right to receive an immediate distribution of his or her plan account even though the employer no longer owns the business, and (7) other proposals relevant to the topic of pension simplification and growth.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should *submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label*, by the close of business, Tuesday, May 19, 1998, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. **Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.**

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

(MORE)

Note: All Committee advisories and news releases are available on the World Wide Web at "http://www.house.gov/ways_means/".

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

*****

Chairman JOHNSON of Connecticut. Good afternoon, ladies and gentleman.

While you're settling, I'm going to start so that we can move forward. We do have three panels this afternoon, and members always have many things pressing on their schedules, and I'd like the maximum number of members to hear what the panelists have to say since the members who are here all represent people who are particularly interested in the subject of pension reform.

Welcome to our hearing to explore how we can help people be more secure in their retirement years. We'll hear proposals to simplify the tax law related to retirement plans and to encourage growth of pension plans. The private pension system is a key part of retirement security for most Americans. Private pensions along with social security and personal savings are the three traditional components of individual retirement security. We can improve the standard of living for retirees by strengthening our pension system.

The first time Congress acted to encourage pension plans to develop through tax incentives was in 1921. Over the past 77 years, Congress has expanded, reformed, refined, amended, and, indeed, tinkered with the pension law numerous times. Some changes were meant to expand pension coverage. Some changes were meant to curb the abuse of a tax subsidized plan. Some changes were meant to assure the fairness of our pension system, and recent changes, unfortunately, were meant to raise the revenue as a part of budget acts.

While each of the separate changes made over the years had a legitimate purpose, the cumulative effect was disastrous. As pension tax law became overly complex, employers began to close out their plans in droves, and new employers shied away from establishing pension plans for their employees. Even professional tax experts could not keep up with the changes; they were so numerous and so constant. Picayune rules and frequent mandates requiring costly, formal amendments to plans cut more and more people out of pension plans rather than cutting more and more people into plans as Congress had intended. Indeed, small employers have to come to feel in the pension area that no good deed goes unpunished.

To its credit, Congress has recognized the need to simplify pension law. In 1996, Congress enacted pension simplification provisions as part of the Small Business Job Protection Act and continued that work in the Taxpayer Relief Act of 1997, and, indeed, as a result of this committee's work, we do have the simple plan out there for small businesses working, making a difference, and one of the things I hope we will hear today is any suggestions you have for making that simpler as I understand that is not yet simple enough. We also, as you well know, have a proposal out there for SAFE which we've already taken testimony on. Again, all these things are always open to your input as we move forward.

Much work needs to be done, and some of the people to whom I'm going to yield in opening statements which is unusual for this committee, have done some excellent work, and this committee is committed to bringing together some of the really thoughtful work that has been done in the area of pension reform to achieve our

goal of opening up tax subsidized retirement savings opportunities for all working people.

A second purpose of today's hearing is to review the fairness of our pension system especially for care givers, primarily women. Traditional pension plans provide the best benefits to people who remain in the work force on a continuous basis. This deeply disadvantages women who often have break in employment either to take care of young family members or old family members. These women would welcome the opportunity to buy back, to make catch up contributions, in their pension plan in order to increase their retirement security. We should explore how pension law could accommodate such important differences in the patterns of our lives in order to provide more equal access to retirement security.

Several members and numerous outside groups have developed constructive proposals to simplify the pension law and to encourage the growth of pension plans. We will review each proposal carefully and prepare for legislative action this session.

I'd like, now, to yield to my colleague and Ranking Member, Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman, and it's good that we're holding this Oversight Subcommittee hearing today. It's the second hearing on pension issues, and I'm especially interested in continuing our discussion of why significant segments of our society are without pensions and how we can simplify our pension laws to expand and increase coverage.

I want to personally welcome Mr. Jeffrey Lewis who is here to present the results of a national poll conducted by the Theresa and H. John Heinz Foundation. The foundation survey concluded that 80 percent of Americans are concerned that they will not have enough money to live on when they retire. In the congressional district that I represent and many others across the country, that fear is justified. Almost half the retirees in the area that I represent in western Pennsylvania live on Social Security; which provides less than $9,000 a year or about $750 a month. Retirees with private pensions have almost twice as much income, but they still have to be very, very careful about their spending habits.

The Heinz Foundation's research also will give us some insight into why so many Americans do not have retirement savings. Fifty to 60 percent of the men and women surveyed reported that they usually have little or no money left after paying their bills to save for retirement. Today, more and more pension plans require employees to contribute in order to participate in retirement plans. That makes it even more important that the Congress address the difficulty many workers have stretching their paychecks to support their families and save for retirement.

I believe the Heinz Foundation's work will be of great help to us in understanding who does not have pension coverage and why they don't have it. Their work in this area is just one of the many contributions the foundation has made to the State of Pennsylvania and the improved well-being of all our citizens.

Also, it is timely for the subcommittee to continue to review various proposals and approaches to expanding pension coverage. In follow up to our earlier hearing on this topic, Congressman Neal of the Ways and Means Committee, introduced H.R. 3672, the Em-

ployee Pension Portability and Accountability Act of 1998. The bill would expand retirement savings and increase access to pensions for millions of employees. I am pleased to have joined in co-sponsoring that particular legislation. Today, we will also have the opportunity to discuss the pension simplification package developed by Congressman Cardin and Congressman Portman. I know we all look forward to hearing more about that proposal.

Finally, all the tools the Congress has provided to promote retirement savings are only helpful if people participate and use them. In July of 1995, the Department of Labor, together with over 100 private and public sector partners, launched the Retirement Savings Education Campaign.

I want to welcome Mr. Dallas Salisbury, chairman of the American Savings Education Council and president of the Employee Benefit Research Institute. He will update us on the tremendous strides the council has made in partnership with the Department of Labor in educating Americans about retirement savings and helping them prepare for life after their work. Also, he will discuss the upcoming June 4th SAVER Act Summit. I believe now is good time to reflect on the progress we have made and the work that is left to do. I look forward to discussing these issues in more detail with the witnesses and my colleagues who have contributed greatly to advancing this discussion. Thank you, Madam Chairwoman.

[The opening statement follows:]

OPENING STATEMENT
THE HONORABLE WILLIAM J. COYNE
SUBCOMMITTEE ON OVERSIGHT
HEARING ON OVERSIGHT OF PENSION ISSUES
MAY 5, 1998

The Subcommittee on Oversight is holding its second hearing this year on pension issues. I am especially interested in continuing our discussion of why significant segments of our society are without pensions and how we can simplify our pension laws to expand and increase coverage.

I want to personally welcome Mr. Jeffrey Lewis, who is here to present the results of the national poll conducted by the Teresa and H. John Heinz Foundation. The Foundation survey concluded that eighty percent of Americans are concerned that they will not have enough money to live on when they retire. In my Congressional district and many others, that fear is justified. Almost half the retirees in Pittsburgh live on Social Security, which provides less than $9,000 a year -- about $750 a month. Retirees with private pensions have almost twice as much income, but they still have to be very careful.

The Heinz Foundation's research also will give us some insight into why so many Americans do not have retirement savings. Fifty to sixty percent of the men and women surveyed reported that they usually have little or no money left after paying their bills to save for retirement. Today, more and more pension plans require employees to contribute in order to participate in retirement plans. That makes it even more important that the Congress address the difficulty many workers have stretching their paychecks to support their families and save for retirement.

I believe the Heinz Foundation's work will be a great help to us in understanding who does not have pension coverage and why. Their work in this area is just one of the many contributions the Foundation has made to my home state of Pennsylvania and the improved well-being of all our citizens.

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Finally, all the tools the Congress has provided to promote retirement savings are only helpful if people use them. In July of 1995, the Department of Labor, together with over 100 private and public sector partners, launched the Retirement Savings Education Campaign. I want to welcome Mr. Dallas Salisbury, Chairman of the American Savings Education Council, and President of the Employee Benefit Research Institute. He will update us on the tremendous strides the Council has made, in partnership with the Department of Labor, in educating Americans about retirement savings and helping them prepare for life after work. Also, he will discuss the upcoming June 4 "Saver Act Summit."

I believe now is a good time to reflect on the progress we have made and the work that is left to do. I look forward to discussing these issues in more detail with the witnesses and my colleagues who have contributed greatly to advancing this discussion.

Chairman JOHNSON of Connecticut. Thank you, Bill. We do have a lot of speakers this afternoon, but in deference to their constructive contribution and, really, many hours of work in preparation for this hearing, let me recognize, first, Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair, and thanks for your leadership on this issue. Not only have you introduced the SAFE legislation that I am proud to co-sponsor that provides a much better defined benefit vehicle for smaller companies, but just by having these hearings—the previous hearing, this one, and into the future—I think you've done a great service by raising public awareness on the needs to increase retirement savings.

I'd also like to thank Ben Cardin who's here joining us on the subcommittee today who has been my partner on some of these pension simplification efforts and co-author specifically of one of the proposals we're going to be talking about today, which Mr. Coyne just mentioned, which is the Retirement Security for the 21st Century Act.

Ben and I teamed up over the last few years and in 1996 and 1997, we were able to get through some pretty good pension reforms, and I think what this bill really is building upon those reforms in, perhaps, a more comprehensive way. It represents a year's worth of work by a lot of people in this room today; members, Nancy Johnson being one; Jerry Weller, I see is with us today, contributed to it; other members; also, a lot of people in organizations, again, many of whom are here and we'll hear from in a moment. All of them deserve a lot of thanks. We don't have time to go through all that, but as it gets into the hearing I'm sure we'll hear from a lot of these people about their contributions to it and specific input. We never could have put all this together without Wade Ballou from House Legislative Counsel, and he deserves some credit today, because it was a gargantuan task to draft the bill and he did it well.

Mrs. Johnson's opening statement and Mr. Coynes' statement, I think, stated the challenge very well. The historical analysis, Nancy, you gave I think is right on, and I think some of the challenges we face in the future, Mr. Coyne spoke about. Bottom line is as we look into the next century, increasing retirement savings just has to be one of our top national priorities. Why? Well, first, to provide a backstop for Social Security which is under increasing pressure, but also to counter these recent trends we've seen of retirement savings going the wrong way.

While Americans have traditionally saved a relatively large percentage of their earnings, these numbers have changed in recent years, and it should be of great concern to us as policymakers, and it's not just an esoteric economic matter for economists and financial analysts to talk about and to lament as compared to our global trading partners and so on, it's a bottom line issue for millions of working families.

If you think about it, there are about 75 million members of my generation, the baby boom generation, now approaching their late forties and fifties, and they aren't ready for retirement. In fact, studies show that older members of the baby boom generation have less than 40 percent of the savings needed to avoid a decline in their standard of living after retirement. We've got to ensure that

this generation and all future generations do have a means toward retirement security.

That's really why we've introduced this bill. It, again, builds on the pension simplification measures and expansion measures like the simple plan for small business that were enacted in 1996; also, the pension provisions to simplify pensions in 1997, and in doing so, it will increase savings and security. First, it expands the availability of pension plans by breaking down the current barriers to savings, it increases the contribution limits, compensation benefit limits that have discouraged employers from establishing new plans or improving existing plans. It eliminated what I think are perverse disincentives in the current system that actually prevent people from setting money aside for their future.

To allow older Americans to prepare for their retirement, it includes a catch up provision for participants 50 years and older. The provision will allow Americans to contribute up to $5,000 per year to a 401(k), 403(b), and 457 plan. In particular, the current limits have hurt women—and Nancy Johnson mentioned this earlier, it was the subject of the last hearing—but women who are returning to the work force after raising families need this catch up provision. It allows them to catch up for all the years they've spent outside the work force or working in part-time positions.

The bill includes portability mentioned by Mr. Coyne a minute ago. The portability provisions allow workers who are changing jobs to roll over retirement savings into different types of plans. Basically, it allows pensions to catch up with the reality of an increasingly mobile work force out there.

With merger mania upon us, it also fixes the "same desk" rule, which I think is very important, by allowing workers to consolidate their 401(k) savings into one account by rolling distributions from their old plan into the plan provided by their new employer. The bill reduces regulatory burdens; it simplifies the complex non-discrimination rules; reforms the sanctions systems; streamlines the very expensive rules currently in place.

There are a lot of other important provisions in the legislation that we don't have time to get into right now, but I know we'll hear about them from our distinguished panel of experts later on. Suffice it to say, I think it is a very comprehensive package; certainly can be improved, and we look forward to hearing from you on that, and, taken as a whole, it will better prepare Americans for the next century.

I want to conclude, Madam Chair, just with the point, the obvious point I hope, that as we continue our critical discussions over saving Social Security—and they are very important—we can't overlook the vital role that private pensions play in providing retirement security for Americans, and that's what this is really all about. This is something we can do now to empower millions of Americans to take charge of their own futures and plan for their retirement. So, again, Madam Chair, I want to thank you for your leadership on the issue and for holding yet another hearing today and for allowing me to make this statement.

Chairman JOHNSON of Connecticut. Thank you very much, and thank you for your fine work on this subject, and, certainly, both your statement and Mr. Coyne's statement make absolutely clear

that even if we are able to have no change at all in Social Security, it doesn't in any way reduce our responsibility or compromise our responsibility to make sure that Americans are far better prepared to live in retirement than simply relying on Social Security.

I'd like to recognize Mr. Cardin who is visiting our committee today in recognition of his responsibility for the bill that we're going to hear before us along with Mr. Porter. Mr. Cardin.

Mr. CARDIN. Thank you, Madam Chairman, and let me thank you for the courtesy of allowing me to make a very brief opening statement. I want to join in commending you for your leadership in holding this hearing. By your statement and by Mr. Coyne's statement, I think it's very clear that this committee is dedicated to trying to make it easier for Americans to plan for their retirement security. So, I congratulate both for your leadership in this area, and I look forward, along with Mr. Portman, working with the subcommittee and the full committee on implementing changes in our pension laws to make it easier for more people to have adequate, private retirement plans.

Among workers in our Nation today, we have found an alarming reduction in their ability to provide for private retirement. If you look at the private savings in the United States, we find that we now are the lowest among the industrial major nations of the world. In our savings ratio, we've fallen in the last generation from 9 percent of personal income to 3.8 percent of personal income. If you look at those workers and firms under 25 employees, only 1 out of 5 have an employer-sponsored retirement plan available to them. The point that you raise, Madam Chairman, about the importance for retirement security is not just Social Security; it's also a person's private savings and a retirement plan that must be in place for retirement security.

Along with Congressman Portman, we have filed H.R. 3788. Congressman Portman has explained the bill or some of the details of the bill. I think you will see that it's a comprehensive approach to reforming our pension law to make it easier for more people to have and participate in retirement plans and for people to be able to put more money away for their retirement. It does some things differently than we've done in the past. As you pointed out, Madam Chairman, in the last couple Congress', we've been reducing the limits that people can put in retirement plans. H.R. 3788, the Retirement Security for the 21st Century Act, increases those limits so people can put more money away; so plans can provide for greater economic security for people in their retirement.

As Congressman Portman pointed out, we recognize the reality of our current work force where people change jobs and, therefore, change the type of retirement plans that they can participate in. We make it easier rather than more difficult for people to transfer their funds, rollover their funds, into different types of retirement plans rather than the current restrictions that make it very complicated and difficult for people to maintain a retirement plan when they change employment.

We provide for catch up provisions, because the reality of today's work force is that people in their younger years are paying college tuition for their children and find it very difficult to put money away for retirement. As they get closer to retirement, they're inter-

ested in trying to do something to make it easier for their retirement years. The pension law should understand that and make it easier for people to provide for their economic security.

And, of course, I think the hallmark of this legislation is simplification. Too many employers, today, are not participating in retirement plans because of the complexities involved. In the last couple Congress', we have taken major steps to try to simplify the retirement law. Still, much more needs to be done. The legislation that Congressman Portman and I have filed moves much further in that direction particularly for small businesses to make it easier for small employers to provide for more retirement security for his or her employees.

It also works not just for private retirement plans but for nonprofit and governmental sectors, because all sectors, all types of employers, need a system that's easier for them to participate in order to take care of their employees needs.

Madam Chairman, I would hope that the committee would give very careful consideration to this legislation. I think you'll find that the many provisions are all well thought out and are aimed at one principle goal—to increase the ability of Americans to plan for their retirement.

I'm very pleased that we have on our panel Art Caple who's from my own State of Maryland, and I also welcome back Glenn English, our former colleague. We look forward to hearing from all the witnesses, and I would ask that my full statement and the summary of H.R. 3788 be made part of the record.

Chairman JOHNSON of Connecticut. Thank you. Mr. Weller.

Mr. WELLER. Thank you, Madam Chair, and, first, let me just commend you on your leadership, and thank you for your leadership on convening today's hearing particularly on the issue of the private pension system which over 100 million working Americans depend on for their retirement income as we work to strengthen what should be a bipartisan priority, and I want to commend you and my friends and colleagues, Representatives Portman and Cardin for their leadership as well. I've enjoyed working with them.

Of course, I just want to make a brief point here, Madam Chair, but I particularly want to focus on an issue that we worked to address, and I appreciate your co-sponsorship along with Representative English, a member of this subcommittee, of H.R. 3632; legislation designed to address some badly needed reform in the area of multi-employer pension funds.

H.R. 3632 addresses the problem created by section 415 of the internal revenue code which sets compensation-based limits and a dollar limit on pension plans. These limitations take an unfair and unintended toll on workers like those in the building and construction trades who rely on multi-employer pension funds for their retirement income. The original intention of section 415 was to prevent wealthy executives from collecting lavish pensions, however, since its enactment in 1974, the provision has been amended to the point where its only meaningful impact is on multi-employer plan participants. Not only have amendments freed corporate executives from these limitations but public officials and public employees are exempted from its most stringent provisions.

Section 415 is preventing multi-employer plans from paying working people the pension benefits they have earned and on which they have relied in planning their retirement. A familiar result is that a carpenter who may have worked for several contractors over his or her career; may have started working as a youth and put in 35 years of hard, physical labor, and for whom retiring at 50 is hardly a luxury, discovers upon applying for his pension benefits that his plan is barred from paying him all that he has earned; finds his plan cut regardless of the plans promises of financial health.

At a time when we in Washington bemoan retirement savings, it's unconscionable that we continue these arcane limitations that punish that do save. We have a unique opportunity to correct this by passing H.R. 3632 which would amend section 415 to include multi-employer pension plans and the list of plans that are exempt from the compensation-based limits and that retain the pre-1986 Tax Reform Act early retirement rules.

Again, Madam Chairman, I thank you for your co-sponsorship of this legislation and look forward to working with you.

Chairman JOHNSON of Connecticut. Thank you very much. I would just comment that rarely have I had the privilege of being part of a subcommittee on Ways and Means where we have so many very, very interested members really committed to making something happen, and my colleague from Georgia, while she agreed not to make an opening statement, is a very regular and committed member of this subcommittee, and we plan to move forward. So, with that, let us start with the first panel. Mr. Klein, president, Association of Private Pension and Welfare Plans; Kenneth Porter, chairman of the ERISA Industry Committee; Dallas Salisbury, the president and CEO of EBRI; Paula Calimafde the Small Business Council of America and the Small Business Legislative Council; Glenn English, former colleague and friend, National Rural Electric Cooperative Association, and Tom Walker, president of the Associated Benefits Corporation.

[The opening statement of Mr. Ramstad follows:]

STATEMENT OF U.S. Rep. JIM RAMSTAD
BEFORE THE WAYS AND MEANS OVERSIGHT SUBCOMMITTEE
May 5, 1998

Madam Chairman, thank you for convening this important hearing on the pension issues.

Retirement security is a critical issue for all Americans, and the conflicting messages sent by our tax laws can be very troubling. On one hand, we have tried to encourage employers to offer employees pension coverage by allowing a current deduction for contributions to qualified plans. But on the other hand, complexities that have been added to the tax code -- not only to curb perceived "abuses" but also to simply raise revenue -- make pensions an administrative headache.

We made some progress on the simplification front in the 1996 Small Business Job Protection Act and last year's Taxpayer Relief Act, but much more remains to be done. I am encouraged by the excellent work of Mr. Portman and Mr. Cardin in crafting a comprehensive proposal to simplify and improve pension administration. I am particularly grateful for their openness and the hard work of their staff to accommodate suggestions I have offered.

I am also pleased that this hearing will address the issue of pension fairness for women, who often must leave the workforce to raise a family or care for an elderly parent.

Again, Madam Chairman, thank you for your own leadership in promoting retirement security, and for holding this critical hearing.

Chairman JOHNSON of Connecticut. Mr. Klein.

STATEMENT OF JAMES A KLEIN, PRESIDENT, ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS

Mr. KLEIN. Madam Chairman and members of the subcommittee, I'm James Klein, president of APPWP, the Benefits Association. I'm accompanied today by Lynn Dudley, APPWP's vice president of retirement policy. Thank you for inviting me this afternoon.

APPWP represents the Nation's major employers and other organizations that serve benefit plan sponsors. Collectively, our members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans. It's a privilege for me to testify at today's hearing along with so many professional colleagues and members of my organization, especially Ken Porter of DuPont sitting to my right, who served as Chair of the APPWP Board of Directors when so many of the initiatives about which I will speak today were being developed by our policy committees and board.

I hope that following my prepared remarks I will be asked many substantive questions about the need for pension law improvements and APPWP's specific recommendations, but I wanted to use a large portion of my formal five minutes, if I may, to speak in more philosophical terms about the significance of today's hearing.

For those of us in the employee benefits community, today's hearing is really no ordinary event. For one thing, we're not generally used to appearing on the so-called victim's panel. Madam Chairman, through the years, very few members of Congress have assumed the mantle of leadership on retirement policy. That's understandable. The specifics of pension legislation are enough to make almost anyone's eyes glaze over. The technical nature of it is difficult to communicate to other lawmakers and the public at large.

Madam Chairman, you have been the exception to the rule. You have recognized the vital importance of a strong employer-sponsored pension system, and you have successfully pressed for legislation to further that goal. Countless Americans, Madam Chairman, have a more secure retirement thanks to your efforts.

Today's hearing accompanies the introduction of legislation of two other members of the Ways and Means Committee who have also distinguished themselves as champions of the private retirement system; and as advocates for the millions of Americans who rely on that system. In previous years, Representatives Portman and Cardin took the lead in advocating important pension simplifications that became law as part of the Small Business Job Protection Act of 1996 and the Taxpayer Relief Act of 1997. Now, Representatives Portman and Cardin have authored H.R. 3788, the Retirement Security for the 21st Century Act. As its name suggests, the legislation goes beyond simplifying many of the complex pension rules. It sets Congress on a course to help Americans better prepare for the challenges of ensuring a secure retirement in the 21st century. In developing this bill, Mr. Portman and Mr. Cardin have demonstrated a clear vision about the need for retirement savings, and they have worked very hard to craft proposals that are fair and prudent. Just as you, Madam Chairman, are ably

served by experienced and dedicated staff—and I note that sitting behind you is Mac McKenny with whom I had the pleasure of working on the original pension simplification bill back in 1990—so, too, have Representatives Portman and Cardin been assisted by their conscientious staff members, Barbara Pate and David Koshgarian, and we want to acknowledge their efforts as well.

APPWP is proud that so many of the proposals we developed some years ago formed the basis for the pension simplification legislation of 1996 and 1997, and we are gratified that many of our more recent proposals for improving the retirement system were embraced by Representatives Portman and Cardin as they drafted H.R. 3788.

In the interest of time, I request that the full text of APPWP's March 1997 report, "Preparing Americans for the Future," as well as the subsequent document from February of 1998 outlining our proposals further, be included in the formal hearing record.

Madam Chairman, my written statement contains extensive analysis of various provisions of current pension law that restrict retirement plan savings. These provisions have been added to the Internal Revenue Code by more than 10 major laws enacted between 1992 and 1994. More importantly, my written statement describes how the Retirement Security for the 21st Century Act would correct these problematic provisions, and, thereby, benefit both plan participants and plan sponsors.

I do not have time to discuss all of these proposals, so allow me to conclude by recommending four broad themes for Congress to consider as it moves forward. First, Congress must reverse years of short-sighted restrictions on the ability of both employers and participants to adequately set aside assets that will be needed to ensure retirement income security, and, in many cases, to pay promised benefits. Americans need to save, and H.R. 3788 will help them do so more effectively.

Second, Congress must recognize that rules governing the pension system should serve rather than impede the need for companies to be competitive. That does not mean that companies should be allowed to save money by choosing not to provide retirement coverage for certain workers; quite the contrary. It means that provisions of current law that restrict employers from covering moderate income workers whom they wish to cover, or that disrupt plan coverage following a corporate transaction need to be modified or possibly repealed.

Third, do not allow revenue loss estimates to dissuade you from passing sound retirement policy proposals. For too long, retirement policy was driven either by the desire to raise tax revenue or to address phantom concerns about retirement plans that favor higher paid workers. Obviously, you must be prudent about paying for proposals that expand pensions. But the pension tax expenditure is worth it. It helps families, especially at the middle income level, and it's a bargain for the Federal Treasury too. Roughly $3 of retirement benefits are paid from private employer-sponsored plans for every $1 of tax expenditure.

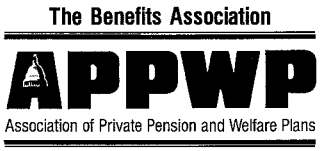
Moreover, and in conclusion, pension contributions not only provide the assets needed to pay retirement benefits but also provide

the investment capital necessary to drive economic growth which leads, in turn, to more tax receipts.

Finally and fourthly, favorable consideration of the Portman-Cardin legislation will make it easier for Congress and the President to make difficult decisions concerning Social Security reform. To the extent that Americans can rely on employer-sponsored plans to provide much needed retirement income, financial pressures on Social Security, and other public programs will be lessened.

Madam Chairman, it may take some time for the provisions of the Retirement Security for the 21st Century Act to become law. But I am convinced that the introduction of this bill, and your decision to hold today's hearing to explore ways to enhance retirement savings, will come to be viewed as the turning point in restoring the traditional role of Congress as a partner in the growth of a vibrant, private sector retirement system. The APPWP commends you and Representatives Portman and Cardin and all who support their efforts. We pledge the APPWP's energy and resources for the passage of this much needed legislation. Thank you.

[The prepared statement and an attachment follows:]



Hearing on Oversight of Pension of Issues

Subcommittee on Oversight

Committee on Ways and Means

United States House of Representatives

Tuesday, May 5, 1998

Statement by

James A. Klein

President

Association of Private Pension and Welfare Plans

(APPWP—The Benefits Association)

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Statement by

James A. Klein
President, Association of Private Pension and Welfare Plans
(APPWP – The Benefits Association)
to the
Subcommittee on Oversight
Committee on Ways & Means
U.S. House of Representatives
May 5, 1998

Madam Chairman and members of the subcommittee, my name is James A. Klein. I am president of the Association of Private Pension and Welfare Plans (APPWP-The Benefits Association). I am accompanied today by Lynn D. Dudley, vice president, retirement policy, for the APPWP.

APPWP is a public policy organization representing principally Fortune 500 companies and other organizations that serve employer plan sponsors. Collectively, APPWP's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

It is, indeed, a great honor for APPWP to appear at today's hearing. Through the years, relatively few members of Congress have willingly taken the mantle of leadership on retirement policy matters. This is understandable. The specifics of pension legislation are often extremely technical and difficult to communicate to other lawmakers and to the public at large. Moreover, proposals to encourage the creation and expansion of employer-sponsored retirement plans have frequently been estimated to involve high levels of foregone tax revenue, making passage of these proposals – especially during periods of large federal budget deficits – difficult to achieve.

Madam Chairman, you have been an exception to general rule. Throughout your career, and especially during your tenure as chairman of this important subcommittee, you have educated Congress and the public about the need for encouraging private retirement plans in order to ensure the retirement income security of millions of Americans. And you have successfully pressed for legislation to further that goal. The employee benefits community and – more importantly – American workers and retirees and their families who are served by private retirement plans, are grateful for your leadership.

Today's hearing accompanies the introduction of legislation by two other members of the House Ways and Means Committee who also have distinguished themselves as champions of the employer-sponsored retirement system, and of the millions of Americans who rely upon that system for their retirement income security. Representative Rob Portman and Representative Ben Cardin have taken the lead in advocating important pension simplifications and improvements that became law as part of the Small Business Job Protection Act of 1996 and the Taxpayer Relief Act of 1997.

Now Representatives Portman and Cardin have authored H. R. 3788, the "Retirement Security for the 21st Century Act". As its name suggests, the legislation goes beyond the simplification of many complex pension rules, as important as that is; but also sets Congress on a course to encourage the establishment of new retirement plans, and the enhancement of existing plans, so that Americans can better prepare for the challenge of ensuring a secure retirement well into the 21st century. In developing this bill, Representatives Portman and Cardin have demonstrated both vision about the need for national retirement savings, and a lot of hard work in crafting proposals that are fair and workable. They have been very ably assisted in this effort by their conscientious staff members, Barbara Pate and David Koshgarian.

The APPWP is proud to have played a continuing positive role in improving the rules governing the employer-sponsored retirement system. Several of the pension simplifications that became law as part of the 1996 Small Business Job Protection Act and the 1997 Taxpayer Relief Act were originally set forth in two APPWP publications "Gridlock: Pension Law in Crisis and the Road to Simplification" (1989) and "Gridlock Revisited: On the Road Toward Pension Simplification" (1991). It is gratifying for the APPWP members who spent many months developing further – more sweeping – changes, which were set forth in our March 1997 report "Preparing Americans for the Future: The Road to an Improved Employment-Based Retirement System" and in our February 4, 1998 "Special Alert", to find so many of these important concepts incorporated in the Portman/Cardin legislation.

It took several years for the original pension simplification proposals set forth in APPWP's 1989 and 1991 reports to become law. And it may take some time for the provisions of the Portman/Cardin "Retirement Security for the 21st Century Act" to be enacted. However, whatever the future holds for these specific proposals, Madam Chairman, I am convinced that the introduction of this legislation, and your decision to hold today's hearing to highlight the need for greater national savings and improvements in the employment-based retirement system, will come to be recognized as a crucial turning point in the national recognition of the need to correct years of ill-advised retirement policies. It will also serve to restore the traditional role of Congress as a partner in the growth and expansion of a vibrant private sector retirement system.

THE PENSION PARADOX

Tax and labor laws enacted over a period of many years have served both to make possible the stunning growth of a voluntary, private retirement system; and, ironically, to stymie the existence of employer-sponsored plans that are necessary to ensure retirement security.

By many objective measures, the laws that encouraged the establishment of a secure employment-based retirement system have resulted in crucial income security and wealth accumulation for older Americans. According to the U.S. Department of Labor, in 1975, immediately following the passage of the Employee Retirement Income Security Act of 1974 (ERISA), there were 38 million total participants (active workers and retirees with vested benefits) in about 310,000 retirement plans. Of these, 103,000 were defined benefit plans and 207,000 were defined contribution plans. By 1994, there were 85 million total participants in approximately 700,000 retirement plans, of which 75,000 were defined benefit plans and 625,000

were defined contribution plans. Please note that the total plan participation numbers represent some double counting for people who participate in more than one plan. Private retirement plans today hold about $3.5 trillion in assets.

While the total number of plans and the assets held by such plans has grown robustly, statistics also tell us a disturbing story. Defined benefit plan levels hit their peak in 1983 with a total of 175,000 plans with about 30 million active worker participants. By 1994, despite the growth in the labor force, there were just 75,000 defined benefit plans nationwide with only 25 million active worker participants. While the defined contribution plan system, especially 401(k) plans, has witnessed tremendous success; overall, the percentage of American workers participating in a retirement plan of any kind has remained essentially flat – at 46% of all workers (50% of all full-time workers) – since 1975.

Tax Driven Retirement Policy and Complexity

To what might this stagnation be attributed? There could be many explanations, but the most plausible, and the most frequently cited by APPWP members and others who sponsor and operate plans, is the steady stream of legislation throughout the 1980's and early 1990's that extracted tax revenue from, and added regulatory burdens to, private plans. Between 1982 and 1994, alone, there were at least ten tax and budget measures that contained pension-related provisions that were aimed at extracting more than $45 billion in tax revenue from employer-sponsored plans. (See Table 1)

Table1
BUDGET AND TAX LEGISLATION AFFECTING RETIREMENT PLANS

Year	Name of Legislation	Estimated Federal Revenue Gain	
1982	Tax Equity & Fiscal Responsibility Act	$3.9 billion	(FY83-87)
1984	Deficit Reduction Act of 1984	$3.0 billion	(FY85-89)
1985	Consolidated Omnibus Budget Reconciliation Act	$0.7 billion	(FY86-88)
1986	Tax Reform Act of 1986	$19 billion	(FY87-91)
1987	Omnibus Budget Reconciliation Act of 1987	$3.2 billion	(FY88-90)
1988	Technical & Miscellaneous Revenue Act of 1988	$ 62 million	(FY89-91)
1989	Omnibus Budget Reconciliation Act of 1989	$9.3 billion	(FY90-94)
1990	Omnibus Budget Reconciliation Act of 1990	$1.6 billion	(FY91-95)
1993	Budget Reconciliation Act of 1993	$2.5 billion	(FY94-98)
1994	GATT Implementation Act	$1.8 billion	(FY95-99)
		TOTAL = $45 billion	

Source: Retirement Savings Network

The federal tax revenue indicated in the list of legislation described in Table1 has been raised through a variety of provisions that have reduced the level of contributions that may paid into, or benefits that may be paid out of, employer-sponsored retirement plans. In addition, the level of compensation that may be taken into account in computing pension contributions and benefits

has been lowered, and cost of living adjustments that would allow funding and benefits to keep pace with rising needs for retirement income security, have been delayed. Not only have plan participants, themselves, been prevented from contributing adequately to retirement savings plans, but artificially low caps on funding plans have also been imposed which have prohibited employers from setting aside sufficient assets to pay promised benefits.

These essentially revenue-driven provisions have also been accompanied by changes in the law that have contributed enormously to plan administration costs. These administrative costs have resulted in plan sponsors dedicating resources to plan operations that could have been better deployed funding benefits. In many instances, these extraordinarily high administrative costs have precluded employers, especially smaller enterprises, from sponsoring a plan at all.

A comprehensive study of administrative costs for large, medium and small plans, during the period from 1981 through 1996, when numerous laws governing the retirement system were enacted, exposes the tremendous burden placed upon retirement plans – especially defined benefit plans (Hustead, 1996). For the small 15 participant defined benefit plan, costs nearly tripled from 1.1% of payroll in 1981 to 3.1% in 1996. This is particularly significant when one considers that the total employer costs for the benefits, themselves, for a typical small plan is around 5% of payroll. Though the total percentage of payroll attributed to administrative costs for a large 10,000 participant plan overall remained low, it did double from 1981 to 1996. Significantly, the administrative costs for such a large defined benefit plan were actually lower than for a defined benefit plan in 1981, but since 1985 the administrative costs of a large defined benefit plan have been greater than for defined contribution plans.

In the same vein, annual administrative costs for a 15 participant defined contribution plan rose from an average of $2,057 in 1981 to $4,308 in 1996 (in constant 1996 dollars). For a 10,000 participant defined contribution plan the cost leaped from $257,109 in 1981 to $491,868 in 1996 (in constant 1996 dollars).

The rising costs associated with plan administration are especially substantial when one considers that these statistics represent only the ongoing administrative costs. These figures do not include the enormous implementation costs that were incurred when plan sponsors had to pay for professional advice, amendment of plans, changing data systems, communicating new rules to participants, and the fulfillment of other responsibilities each time Congress passed a new law, during the 1981 to 1996 period, that affected retirement plan sponsorship.

UNDERSTANDING THE PENSION TAX EXPENDITURE

Frequently, throughout the 1980's and early 1990's, while raising tax revenue was the real motivation for many changes in the law, the publicly-stated purpose of a particular change was the desire to ensure that the tax expenditure for retirement plans was not too heavily weighted toward higher-paid plan participants. In this regard, both the actual revenue losses attributable to employer-sponsored retirement plans, and the portion of the tax preference enjoyed by higher-paid employees is seriously misunderstood.

Clarifying the pension tax expenditure is important, because undoubtedly certain provisions of the "Retirement Security for the 21st Century Act" will be challenged on the basis that they would lead to revenue loss, or result in higher paid workers enjoying a disproportionate share of the value of the tax expenditure.

In Fiscal Year 1998 the tax expenditure for employer-sponsored retirement benefits is estimated to be about $72 billion. Without further elaboration, this figure can be misleading for at least two reasons. First, approximately half of the tax expenditure is attributable to plans sponsored by public entities (e.g. federal, state and local governments). So the amount of foregone tax revenue resulting from private plans is actually much lower than the commonly used tax expenditure figure.

Second, unlike most other tax expenditures, the "lost" revenue resulting from compensation that is contributed to a retirement plan, rather than being paid in the form of immediately taxable wages, is not indefinitely foregone. Rather, it is deferred until paid-out in the form of taxable retirement benefits. As the baby boom generation moves into its retirement years, the federal government will see a dramatic increase in tax receipts on benefit payments from retirement plans.

Third, the tax expenditure for retirement plans is actually a comparatively non-expensive means of delivering retirement income security. According to data from the Bureau of Economic Analysis, total benefits paid from private plans is roughly three times the foregone federal tax receipts accorded to private employer-sponsored retirement plans. That means for every $1 of tax expenditure, private plans are paying $3 to retirees and survivors. That is not only a tremendous bargain for the individuals involved, but a great bargain for the federal Treasury (and the taxpayers who support it) which would have to pay roughly three times as much to provide the same level of retirement security that results from encouraging a voluntary, private employer-sponsored system.

The widely-held viewpoint that employer-sponsored retirement plans favor highly paid executives, is another misconception that has resulted in much misguided legislation that has precluded both the sponsorship and breadth of plan coverage, and added layers of wasteful complexity to those plans that do exist.

Two separate studies conclude that middle-income families, not high-income families, are the largest beneficiaries of the tax preference accorded to employer-sponsored retirement plans. (Schieber, 1990; Salisbury, 1993). Specifically, Schieber's analysis determined that workers with family incomes between $15,000 and $50,000 are the largest beneficiaries of the tax preferences since they account for 61% of all pension accruals, but only 36% of all federal tax collections. In a subsequent study, Salisbury categorized the upper income taxpayers even further, and determined that workers with family incomes over $100,000 represented about 20% of the value of the pension tax expenditure, while the same group accounted for 41% of tax liability.

Accordingly, continued efforts to reduce the perceived tax preference to higher paid individuals – such as the provision of the Budget Reconciliation Act of 1993 which reduced the amount of

compensation that can be taken into account in computing pension contributions and benefits from its $235,840 level in 1993 to $150,000 (indexed) – are unnecessary and counterproductive. In fact, because of the way plans are funded to account for future wage growth, this particular ill-advised change in the law in 1993 has prevented many employers from adequately funding for benefits that are to be paid several years from now to many moderate income earners.

PENSIONS AND NATIONAL SAVINGS

An analysis of employer-sponsored retirement plans that evaluates their value only in terms of the tax expenditure would be a far too narrow analysis. Even to the extent that the pension tax preference does account for foregone tax revenue, it is unquestionably a tax expenditure that is worth the cost. The approximately $3.5 trillion of assets held by private sector plans is not only an enormous sum of money to pay current and future retirement benefits; but also represents about one fifth of the nation's wealth (Shoven, 1991). These assets are an indispensable source of capital needed to make the U.S. economy function.

Many policy-makers have rightly decried the low level of savings in the United States. According to research commissioned by the APPWP a number of years ago, were it not for the employment-based retirement system, the U.S., throughout the entire decade of the 1980's, not only would have had a low national savings rate – but, in fact, would have experienced net negative savings (Shoven, 1991).

Last year Congress wisely enacted, and the President signed, legislation that called for a National Summit on Retirement Savings to explore the state of retirement savings and determine how to improve it. As the leading policy-makers from the public and private sectors gather at the summit a month from now to discuss the importance of retirement savings, they would be well advised to examine the provisions of the "Retirement Security for the 21st Century Act". With this legislation, Representatives Portman and Cardin have provided the delegates to the national summit with a list of very practical and achievable proposals to make it possible for both employers and workers to do more to boost the level of national retirement savings.

Congress will consider the proposals set forth in the "Retirement Security for the 21st Century Act" against the backdrop of a much larger national debate on reforming the Social Security system. There, too, policy options appropriately will be considered in terms of the affect of reforms on actual benefits paid to retirees as well as the implications for capital formation in the United States. Difficult decisions concerning promised benefits from a reformed Social Security system will be much easier to make, if the private employer-sponsored retirement system will sit on a firmer foundation, and if retirees at all income levels will be able to receive more meaningful benefits from employer-sponsored plans. Favorable consideration of the Portman/Cardin legislation, therefore, will not only be important on its own merits, but also will represent an important effort to shore-up the private retirement system before Congress and the President undertake the far more difficult task of Social Security reform.

THE RETIREMENT SECURITY FOR THE 21st CENTURY ACT

The foregoing discussion has hopefully set forth the vital importance of the private, voluntary retirement system both for ensuring retirement income security and for providing a source of capital accumulation needed to drive the engine of economic growth. While enlightened tax and retirement policy over many years helped create a framework within which employers are encouraged to sponsor plans for their workers, misguided tax policies – especially during the years of significant federal budget deficits – have undermined that employment-based system at a time when it should have been encouraged to grow to prepare Americans for the significant retirement income needs of an aging baby boom generation.

Accordingly, the aptly titled "Retirement Security for the 21st Century Act" includes a number of provisions that seek to reverse the shortsighted policies contained in many previously enacted measures. The provisions developed in the legislation are too numerous to explain in this written statement. However, the justification for many of the changes in the bill, and the specific recommended solutions, are set forth in the APPWP's March 1997 report, "Preparing Americans for the Future: The Road to an Improved Employment-Based Retirement System" and in Special Alert 98-1 to APPWP members dated February 4, 1998. Madam Chairman, I ask permission that the full text of this report, and relevant portions of the APPWP Special Alert, be inserted in the official record of this hearing.

Allow me to briefly describe the problems caused by certain provisions of current law and the enlightened way in which the "Retirement Security for the 21st Century Act" addresses those concerns.

Expanding Coverage and Savings

***Restore Dollar Limits.** One of the most significant elements of the legislation is to restore a variety of statutory dollar limits that were formerly in effect. Many limits on benefits and contributions in plans are far lower today in actual dollar terms – to say nothing of the erosion of their value due to normal inflation – than they were many years ago. Accordingly, the current Internal Revenue Code [IRC] Section 415(c) limit on annual contributions to defined contribution plans, which is the lesser of 25% of compensation or $30,000, which has been in effect since 1983, would be dramatically improved under the Portman/Cardin bill. The $30,000 limit would be increased to $45,000 (and would be indexed in $1,000 increments rather than $5,000 increments) and the 25% of compensation feature would be repealed.

The IRC Section 415(b) limit on maximum benefits under a defined benefit plan is just $130,000 in 1998 even though as long ago as 1982 the limit was $136,425. Even worse, current law requires substantial actuarial reductions for early retirees who may need to rely on their pension benefits for a variety of reasons. Under the bill, the limit would be raised to $140,000 and actuarial reductions would only be required for benefits beginning before age 62.

As described earlier in this statement, prior to changes made in the Budget Reconciliation Act of 1993, IRC Section 401(a)(17) allowed $235,840 (the indexed number as of 1993) to be taken into account in determining benefits. That level was reduced to $150,000 (to be indexed in

$10,000 increments) and currently is $160,000. The Portman/Cardin bill would restore the limit to a more sensible $235,000 and index that level in $5,000 increments.

The IRC Section 402(g) limit on elective deferrals under salary reduction plans (e.g. 401(k), 403(b) and SEPs, etc.) is currently $10,000 per year. This would be increased to $15,000 under the legislation.

***Employee Stock Ownership Plan Dividend Deduction.** Presently, deductions are allowed under IRC Section 404(k) on dividends paid on employer stock to an unleveraged ESOP only if the dividends are paid to employees in cash. The deduction is denied if dividends remain in the ESOP for reinvestment. This rule certainly seems to be contrary to sound public policy that would promote both retirement savings and employee ownership. The Portman/Cardin bill would rectify this problem by allowing employers to deduct dividends that remain in the plan for reinvestment

***Top Heavy Rules and Salary Reduction SIMPLE Plans.** A number of cumbersome rules severely limit the ability of small businesses to operate retirement vehicles for their key personnel and, thereby, their broader workforce. The Portman/Cardin legislation takes special note of the needs of small businesses where the risk of lack of coverage is substantial. Among the many changes provided, the top heavy rules would be modified to repeal the family aggregation rules, to delete the top 10 owner rule from the definition of key employee, and to increase to $150,000 the compensation that an officer must have to be treated as highly compensated.

Enhancing Fairness for Women and Children

***Catch-Up Contributions.** Many workers approaching retirement find that they have not accumulated sufficient resources in their plans to ensure adequate retirement income. This is especially true for women who more likely experienced interrupted service in the workforce while they took principal responsibility for raising children. Moreover, many workers may find that only toward their final years of work, when housing and children's education needs have eased, do they have enough discretionary income to make meaningful retirement savings contributions. The "Retirement Security for the 21st Century Act" wisely addresses this problem by permitting individuals age 50 and older to make additional contributions of up to $5,000 per year to 401(k), 403(b), 457, and most types of SIMPLE plans.

***Minimum Distribution Rules.** Numerous requirements under the IRC Section 401(a)(9) minimum distribution rules would be updated and simplified. These rules are especially disadvantageous for a woman who is most likely to be the surviving spouse in a marriage and, thereby, be subjected to minimum distributions that had begun to be paid to her husband prior to his death. However, that distribution may not be appropriate for her retirement income needs. For this reason and many others, APPWP has long advocated the complete repeal of these complex rules. Although this legislation does not fully repeal these rules, we believe the simplifications set forth in the Portman/Cardin bill represent real progress.

Under the bill, the age at which distributions must begin would be increased from 70-1/2 to 75 to account for the fact that many people are working to a later age and living longer. The bill would also reduce from 50% to 10% the current law excise tax on amounts not meeting minimum distributions. Significantly, the first $300,000 of an account balance from both a defined contribution plan and an IRA would be excluded from the minimum distribution requirements.

Increasing Portability for Participants

***Same Desk Rule.** Inconsistent and rigid rules that are incompatible with a changing economy are an impediment to many workers who logically wish to keep their retirement nest egg in a single plan. Unlike in a defined benefit plan, distributions from a 401(k) or many other types of defined contribution plans are not permitted to be made to a terminated employee if the employee continues performing the same function for a successor employer (i.e. continues to work at the "same desk"). This situation arises frequently when there is a corporate transaction such as an acquisition or the establishment of a joint venture owned in part by the worker's former employer.

The "Retirement Security for the 21st Century Act" fixes this so-called "same desk rule" by changing the standard from one which allows distributions when there is "separation from service" to one that permits the distributions when there is "severance from employment", thereby enabling workers to roll over their 401(k) account balance to their new employer's 401(k) plan or an IRA. Similar relief is provided for other types of defined contribution plans.

***Plan to Plan Transfers.** In today's mobile workforce, and increasingly into the 21st century, workers are moving from job to job and amongst different types of employers (e.g. private for-profit employers, non-profit organizations, public entities). These types of employer organizations sponsor different types of retirement plans with very different rules and artificial barriers to the movement of plan assets as an employee moves from job to job. Under the legislation, the barriers amongst different types of plans (e.g. 401(k), 403(b) 457, etc.) would be largely dismantled.

Moreover, the current law IRC Section 411(d)(6) "anti-cutback" rule would be changed so that an employee would be permitted to elect to transfer assets from one plan to another without requiring the transferee plan to preserve the optional forms of benefit under the transferor plan if certain requirements are satisfied. In addition, optional forms of benefit in a defined contribution plan could be eliminated, if the plan has a lump sum option and certain other conditions are satisfied.

Strengthening Pension Security and Enforcement

***Repeal of the 150% of Current Liability Funding Limit.** Presently, contributions to a defined benefit plan are not deductible to the extent the plan's assets exceed either 150% of the current liability or a limitation based on a reasonable projection of benefits. This is a classic example of a shortsighted policy, enacted as part of the Omnibus Budget Reconciliation Act of 1987, simply to raise revenue at the expense of sound plan funding.

Public policy should rightfully be concerned about plan sponsors who are unwilling or unable to fund for the benefits they have promised to pay. But it makes no sense – as America moves into the 21st Century, with all of the challenges that the government and private employers face to ensure adequate retirement income security – to prevent companies from funding the benefits they have promised to their workers, and which the companies are fully prepared and willing to fund. This prohibition is especially problematic for companies with comparatively young workforces whose current liability, therefore, is relatively low, but whose financial obligations in the future will be much greater as those young workers retire.

Wisely, the arbitrary funding limit of current law, which leads to systematic underfunding and erratic plan contribution patterns, would be repealed for plan years beginning after December 31, 2003.

***Miscellaneous Provisions.** The Portman/Cardin legislation provides for several other measures to strengthen pension security and enforcement including: repeal of the 10% excise tax on non-deductible contributions to a defined benefit plan up to the plan's full funding limit, expansion of the Pension Benefit Guaranty Corporation's missing participant program to defined contribution plans and multiemployer defined benefit plans, and relief under the ERISA Section 502(l) civil penalties for breach of fiduciary responsibility which, as currently written, discourage parties from settling claims with the U.S. Department of Labor.

Reducing Regulatory Burdens

As discussed at length, above, there are numerous complex and costly rules that impose undue regulatory burdens on retirement plan sponsors. These regulations cumulatively represent a serious threat to continued plan sponsorship, to say nothing of new plan formation. Even where the administrative cost and inconvenience is not sufficient to impede plan sponsorship, the dollars spent on wasteful compliance represent dollars that could be allocated to greater retirement benefits or more productive non-retirement oriented purposes. At a time when the nation's eye is rightfully trained on improving national savings and encouraging expansion of employer-sponsored retirement plans, public policy can not condone the continuation of rules that frustrate plan formation and administration. APPWP has identified numerous rules that fall into this category, and has suggested ways in which the rules can be vastly improved without undermining the policies that they purport to advance.

We commend the authors of the "Retirement Security for the 21st Century Act" for also recognizing the obstacles created by these rules, and identifying prudent solutions.

***Nondiscrimination Rules.** The current complicated and rigid mechanical tests, purported to ensure plan nondiscrimination, often yield clearly inappropriate results. For example, certain employers maintain a defined benefit plan that covers all nonexcludable employees under a uniform benefit formula and apply all plan benefits, rights and features on uniform plan terms. By any logical, objective measure, this plan does not discriminate in favor of higher paid individuals. However, under current law, even one highly compensated employee, who was hired at a young age and therefore qualifies for the plan's early retirement subsidy at an earlier age than many of the employer's non-highly compensated employees (who just happened to have

been hired at an older age) can cause the plan to run afoul of the nondiscrimination rules. Regrettably, this is not just a theoretical problem but, rather, is one faced by many employers who are quite obviously providing retirement coverage in a nondiscriminatory fashion.

In addition, under application of the nondiscrimination rules, many plan sponsors who want to provide retirement plan coverage to their long-term employees, are unable to do so given the profit margins of their particular industry.

Accordingly, because of these various anomalies and obstacles, the Portman/Cardin bill would replace the rigid and contradictory rules with a standard that permits a more flexible "facts and circumstances" test, and that allows a company to demonstrate compelling business reasons for a particular plan's coverage.

***Separate Lines of Business.** Companies that engage in different industries with different wage and benefit practices are supposed to be able to avail themselves of rules that permit the plan sponsor to test retirement plans for nondiscrimination on a separate line of business (SLOB) basis. In fact, the rules as written impose draconian testing and employee allocation requirements that make them unworkable. The Internal Revenue Service essentially admitted this when it published the rules and estimated that only about 700 plans nationwide would be able to avail themselves of the SLOB "relief". APPWP members do not report any relief whatsoever from these nonsensical rules that, among other things, require an employer to pass a "gateway" nondiscrimination test that applies on an employer-wide basis; thereby undermining the entire purpose of the SLOB concept.

The Portman/Cardin legislation wisely repeals the "gateway" test and modifies the SLOB rules to convert the entire test into a facts and circumstances approach.

***Multiple Use Test.** The Portman/Cardin bill would eliminate the enormously complex rule that prevents a 401(k) plan from using the maximum difference allowed between the highly compensated employees' average matching and employee contributions, and the same contributions for the non-highly compensated employees, for purposes of determining that a plan is nondiscriminatory.

***Sanctions for Inadvertent Failures.** One of the most troubling aspects of the law and procedures governing the administration of retirement plans concerns the way penalties and sanctions are imposed even for innocent mistakes. Clearly, when employers are dealing with rules as complex as those regulating retirement plans, errors will occur. Many employee benefit practitioners believe that there probably is not a retirement plan in the nation that is fully in compliance with all applicable rules. Indeed, one could request a letter from two different offices of the Internal Revenue Service seeking determination that a particular plan is qualified under the law, and very possibly receive two different answers!

APPWP believes that enforcement efforts should focus on promoting good faith compliance and encouraging corrections of any inadvertent errors that occur; and that neither plan sponsors nor participants should settle for "relief" that fails to meet such a logical standard of basic fairness.

The Internal Revenue Service has made progress in improving its compliance programs and the recent pronouncement, Rev. Proc. 98-22 is a movement in the right direction for which the agency should be commended. The Portman/Cardin legislation takes this relief further by ensuring that no sanctions or penalties could be imposed if errors are voluntarily corrected prior to an audit. In addition, any sanctions could not exceed a reasonable amount in relation to the amount involved in the error.

***Notice of Consent Relief.** If a participant has a vested benefit in excess of $5,000, the benefit generally can not be distributed prior to age 62 or normal retirement age unless the participant consents. Such consent is not valid unless the participant receives an explanation of the distribution options no more than 90 days before benefit commencement. This harsh rule leads to all sorts of unfair consequences to plan participants. It sometimes prevents distribution of benefits to a participant who has recently separated from service, perhaps as a result of a company downsizing for example, and for whom the plan sponsor wishes to make a benefit payment.

This rule represents the ultimate in form over substance for its insistence that distributions not be made more than 90 days after an explanation is provided, even if it means that a company is literally prohibited from paying a benefit to a deserving participant to whom the company wants to make the distribution. As the APPWP has long advocated, the Portman/Cardin bill changes the 90 day requirement for plans offering a qualified joint and survivor annuity option, to a rule requiring notice no more than one year before the distribution date.

***Plan Cash-out Rule.** If a terminated participant has a vested accrued benefit of $5,000 or less, the plan may distribute such benefit in a lump sum without the consent of the participant or the participant's spouse. This amount is not indexed for inflation. In addition, in applying the rule, the plan sponsor is required to look back to determine if an individual's account ever exceeded $5,000.

The cash-out rule obviously is intended to allow employers to avoid the payment of extremely small annuity checks and to avoid maintaining records of small frozen accounts for long periods. The proposed legislation would index the cash-out amount in $500 increments and also directs the Secretary of Treasury to repeal the look back rule.

CONCLUSION

The APPWP applauds Representatives Portman and Cardin for their vision and leadership in seeking to restore a large measure of fairness and logic to the rules governing employer-sponsored retirement plans. We are gratified that several practical recommendations developed by the APPWP have been incorporated into the "Retirement Security for the 21st Century Act." The APPWP believes that the introduction of this legislation, and Chairman Johnson's decision to hold this hearing to explore positive ways to enhance the employer-sponsored retirement system, represents a true turning point in national retirement policy and the bipartisan effort to enhance retirement savings. APPWP pledges its full energy and resources to the passage of the "Retirement Security for the 21st Century Act."

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APPWP The Benefits Association

SPECIAL ALERT

February 4, 1998
SA-98/1

An employee benefits call to action

APPWP LOBBIES FOR PENSION LEGISLATION: MEMBERS SUPPORT NEEDED

Action Requested: Outlined below are major proposals that APPWP has developed and has been lobbying for inclusion in bi-partisan legislation. Your support is needed. Please contact your legislative representatives, especially the House Ways & Means Committee and Senate Finance Committee members (a list is attached), to express support for any of these proposals that you find helpful. It is very important that you inform us of those items you support.

Background: The Baby Boom generation's growing attention to savings issues has increased Congressional interest in retirement issues. The inclusion of pension items in the President's Budget proposals, the National Summit on Retirement Savings being planned for June, and an increasing interest in Social Security's financing problems (including the possibility of privatized accounts), will all serve to increase public awareness of retirement issues in the weeks and months ahead. These trends create an environment where change is possible and perhaps inevitable. Those changes could improve our pension system or threaten it with further complexity and administrative burdens.

In anticipation of this changing environment, APPWP's Retirement and Investment Policy Committee and Board of Directors over the past several months, developed a number of proposals that we believe will allow retirement system rules to better serve plan sponsors' needs. Some items were successfully included in the Taxpayer Relief Act, enacted last year. Other proposals, which either were not enacted last year, or have been developed since the passage of the Taxpayer Relief Act, are our priorities for this year.

APPWP Legislative Priorities: The issues that are high on the APPWP list of recommended changes include:

Raising Dollar Limits -- Increasing the amount of compensation that can be taken into account above the $150,000 indexed level and raising the annual contribution and benefit limits under Section 415 for both defined contribution and defined benefit plans remain

-more-

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APPWP priorities. Similarly, increases in the maximum dollar amount of elective deferrals under 401(k), 403(b), 457, and other plans are also part of APPWP's agenda.

Repeal 25% of Compensation Limit -- APPWP advocates repeal of the 25% of compensation limit on annual contributions (IRC Section 415(c)) and comparable changes in the exclusion allowance under 403(b) plans and the percentage limitation under 457 plans.

Repeal the Same Desk Rule -- APPWP supports replacing current rules that limit distributions to "separation from service" with rules that allow distributions upon "severance from employment". These changes would apply to Sections 401(k), 403(b) and 457 plans.

Section 411(d)(6) Relief -- APPWP believes that an individual should be able to waive certain anti-cut back protections when assets are moved from one plan to another and that such waivers should be available to both defined contribution and defined benefit plans.

Continued Progress toward Fairer Sanctions -- APPWP has developed proposals that move toward a sanctions system that encourages compliance and does not impose unfair penalties for inadvertent violations. Changes of this nature could be achieved through continued improvement in the existing IRS compliance programs or through legislation.

Allow Salary Reduction "Catch-up" Contributions -- APPWP supports allowing an annual $5,000 "catch-up" contribution to 401(k), 403(b), SIMPLE and 457 plans for anyone who is at least 50 years old. This would allow those approaching retirement to make up for years when they did not contribute enough, without imposing burdensome tracking requirements with respect to actual past contributions that would result from other types of proposals that permit catch-up contributions.

PBGC Premiums and Defined Benefit Plan Funding -- In many cases, the assumptions required for calculating the PBGC variable rate premium and minimum funding requirements do not reflect a market rate of return or the unique characteristics of the employer's workforce. APPWP supports appropriate modifications in these assumptions. APPWP also supports complete repeal of the current liability full funding limit, repeal of the 10% excise tax on most nondeductible contributions, and simpler rules on timing of plan valuations.

Mortality Assumptions -- In some instances the currently required mortality assumptions are significantly different from actual experience, resulting in inappropriately high contributions. Therefore, APPWP advocates providing plan sponsors relief through use of a mortality table other than the one prescribed under ERISA, if the plan sponsor can demonstrate that such other table more accurately reflects the actual or projected experience of the plan.

ESOP Dividend Deductions -- APPWP supports allowing ESOP dividends to be reinvested without loss of the dividend deduction.

Streamline Nondiscrimination Testing -- APPWP believes changes in the mechanical nondiscrimination rules would allow employers the flexibility to design retirement plans to meet the unique needs of diverse workforces. The Separate Line of Business (SLOB) rules should be streamlined and simplified. Similarly, a plan should have the option of showing compliance with general nondiscrimination rules based on facts and circumstances.

Incentives for Small Business Plans -- Repeal or modification of the top heavy rules remains an APPWP legislative priority. APPWP's position is that if repeal is not achievable, then the top-heavy rules should be simplified in a number of ways, including simplification of the key employee definition, not taking elective contributions into account in determining whether a plan is top-heavy, and allowing matching contributions to be taken into account in determining minimum contribution requirements. Other proposals that APPWP supports include allowing self-employed individuals to get plan loans, and allowing a salary reduction-only SIMPLE plan with no minimum employer contribution.

Simplify Minimum Distribution Rules -- The current minimum distribution rules create administrative burdens for plans and force America's seniors to deal with a complex maze of potentially irrevocable distribution options. APPWP supports simplifying and updating these rules. Actions that warrant consideration include complete repeal, raising the age of required distributions from age 70~/: to age 75, using more recent mortality tables, eliminating rules that disadvantage surviving spouses, allowing slower minimum distributions than are currently required, and reducing the current 50% excise tax.

Multiple Use Test -- APPWP advocates repeal of the multiple use test under the 401(k) plan nondiscrimination rules to eliminate an unnecessary layer of administrative complexity for 401(k) plans.

Rollovers of After-Tax Contributions -- APPWP supports allowing rollovers of after-tax contributions from qualified plans into IRAs.

Please let us know which of these proposals would benefit your company so that we can develop a comprehensive effort to enact these proposals. Naturally we also welcome any comments on these items or other suggestions.

[An additional attachment is being retained in the Committee files.]

Chairman JOHNSON of Connecticut. Thank you, Mr. Klein.

Because we do have so many people testifying today on three panels, I do have to ask you to please try to stay within the light, so we'll have time for some questions.

Mr. Porter.

STATEMENT OF KENNETH PORTER, CHAIRMAN, ERISA INDUSTRY COMMITTEE

Mr. PORTER. Thank you, Madam Chair. My name is Kenneth Porter. I am the chairman of the ERISA Industry Committee, commonly known as ERIC. I'm appearing before the subcommittee on ERIC's behalf this afternoon.

ERIC enthusiastically supports many of the provisions of H.R. 3788, and we thank Congressmen Portman and Cardin and their staffs for the vision——

Chairman JOHNSON of Connecticut. Excuse me, Mr. Porter, could you put the microphone directly in front of you? Yes, thanks. You have to be close; that's it, that's fine.

Mr. PORTER. All right. This might be better. ERIC enthusiastically supports many of the provisions of H.R. 3788, and we commend Congressmen Portman and Cardin and their staffs for the vision, the wisdom, and the commitment in introducing this groundbreaking bill. We also would like to thank the subcommittee for affirmatively addressing the many important retirement security issues raised herein.

Let me briefly highlight of the few of the several provisions in H.R. 3788 that ERIC strongly supports and that will, first, increase benefit security and enhance retirement savings; second, will increase portability, and, third, will rationalize rules affecting the administration of plans. As shown in my first attachment, the Internal Revenue Code imposes a dizzying array of limits on the benefits that can be paid from and the contributions that can be made to tax-qualified plans. It was not always that way.

The limits originally imposed by ERISA in 1974 allowed nearly all workers participating in employer-sponsored plans to accumulate all of their retirement income under funded tax-qualified plans. Between 1982 and 1994, Congress enacted laws that repeatedly lowered the limits and imposed wholly new limits. The result is that today's employers increasingly must rely on non-qualified, unfunded plans. H.R. 3788 turns this tide at a critical time. If we wait until the baby boom cohort begins to retire, it will be too late for employers to accumulate the cash needed to pay for increased pension liabilities and for employees, who will be out of time to accumulate retirement savings.

H.R. 3788 provides an opportunity we cannot afford to pass up. The provisions of the bill are significant, but by no means are they excessive; they're moderate. For example, section 101 significantly increases the benefit and contribution limits by restoring them to the levels allowed 16 years ago in 1982, but, after allowing for inflation, the limits in the bill would still be less than 60 percent of the value of the 1982 limits.

Regarding pension portability, in today's world, employers and employees increasingly are involved in business mergers, acquisitions, and divestiture. Current law often makes it difficult for employees to transfer their retirement savings from one plan to another and to consolidate their retirement savings in a single plan where they can manage it effectively and efficiently. H.R. 3788 addresses this problem. As shown in a chart in attachment B, 401(k) plans are the only plans where a rollover sometimes may not be permitted. This anomaly is caused by the provision of the law called, "same desk rule." This special restriction makes it difficult for employees to keep track of their accounts with former employers, and employers, themselves, find it difficult to keep track of former employees who may not remember to send a change of addresses to their former employer. The bill repeals this rule.

Current Treasury regulations discourage plans from allowing employees to elect to transfer benefits from plan to another. ERIC strongly supports the provisions of this bill that would address that problem.

ERIC also strongly supports the provisions to allow an employee's after-tax contribution to be included in a rollover. Current law can force employees to reduce their retirement savings before they're ready to retire.

Finally, we are very pleased that H.R. 3788 significantly advances the work Congress began in earlier bills to strip away regulatory barnacles. Many current rules unnecessarily increase the cost of plan administration, discourage plan formation, and make retirement planning more difficult for employees.

In conclusion, Madam Chairman and members of the subcommittee, ERIC applauds Congressmen Portman and Cardin for the introduction of this bill. ERIC looks forward to completing its analysis of the bill and to providing the subcommittee with additional comments on it. It is clear that the bill's vision will help ensure that currently and in the future we will have better opportunities to prepare for retirement security, and that employees will be better able to sponsor and administer plans that are coherent and efficient. The bill's strong support for funded, tax-qualified plans sponsored voluntarily by employers for their employees fills a vital need in our Nation's retirement framework, and I thank the subcommittee, Madam Chair, for the opportunity to testify and will be pleased to answer your questions.

[The prepared statement follows:]

TESTIMONY OF
KENNETH W. PORTER
ON BEHALF OF THE ERISA INDUSTRY COMMITTEE
BEFORE THE OVERSIGHT SUBCOMMITTEE OF THE
COMMITTEE ON WAYS AND MEANS OF THE
U.S. HOUSE OF REPRESENTATIVES
AT A HEARING ON H.R. 3788,
"THE RETIREMENT SECURITY FOR THE 21ST CENTURY ACT"

May 5, 1998

Good afternoon. My name is Kenneth Porter. I am the Chairman of The ERISA Industry Committee, commonly known as "ERIC," and I am appearing before the Subcommittee this afternoon on ERIC's behalf. I also serve as Chief Actuary of the DuPont Company.

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, and welfare benefit plans of America's largest employers. ERIC's members provide comprehensive retirement, health care coverage, and other economic security benefits directly to some 25 million active and retired workers and their families. ERIC has a strong interest in proposals affecting its members' ability to deliver those benefits, their cost and effectiveness, and the role of those benefits in the American economy.

ERIC is gratified that, in holding this hearing, the Subcommittee and its Chair have displayed a strong interest in affirmatively addressing long-term retirement security issues. ERIC believes strongly in the importance of addressing these security issues.

ERIC enthusiastically supports the direction set by H.R.3788, and we wish to thank Congressmen Portman and Cardin and their staffs for the vision, wisdom, and commitment that they have displayed in crafting and introducing this ground-breaking bill. H.R.3788 contains significant changes that will strengthen the retirement plans that employers voluntarily provide for their employees and improve the ability of workers to provide for their retirement.

ERIC is familiar with and strongly advocates the speedy enactment of several provisions in the bill that I will discuss below. There are some provisions in the bill that we have not yet had an opportunity to evaluate. We look forward to studying these provisions in the near future and to sharing our views with the Subcommittee and its staff.

Let me briefly highlight for the Subcommittee several provisions in H.R.3788 that ERIC strongly supports and that will (1) increase benefit security and enhance retirement savings, (2) increase pension portability, and (3) rationalize rules affecting the administration of plans.

Improved Benefit Security and Enhanced Retirement Savings

The Internal Revenue Code imposes a dizzying array of limits on the benefits that can be paid from, and the contributions that can be made to, tax-qualified plans. It was not always that way.

The limits originally imposed by ERISA in 1974 allowed nearly all workers participating in employer-sponsored plans to accumulate all of their retirement income under funded, tax-qualified plans. Between 1982 and 1994, however, Congress enacted laws that repeatedly lowered the ERISA limits and imposed wholly new limits. *See* Attachment A. The cumulative impact of reduced limits has been to reduce significantly the benefits that can be paid from funded, tax-qualified plans as well as the ability of workers to save for their retirement.

H.R.3788 turns this tide at a critical time. This Subcommittee does not need to be reminded that the baby boom cohort is rapidly nearing retirement, and that it is critical for them and for our nation that these individuals do all they can to prepare for their own retirement. Retirement planning is a long-term commitment. If we wait until this group has begun to retire, it will be too late. Many employers will not have excess cash available to pay for rapid increases in pension liabilities, and

employees will not have time to accumulate sufficient savings. We must act now. The provisions of H.R.3788 open that door. It is an opportunity we cannot afford to pass up.

The bill (§ 101) restores benefit and contribution limits to the levels previously in effect. It is a measure of how restrictive current law is that the landmark progress represented in this bill merely restores limits that were in effect in 1982, sixteen years ago. The bill increases savings opportunities in defined contribution plans and 401(k) plans and makes numerous other important and needed changes in the limits imposed on tax-qualified plans.

For example, the Tax Equity and Fiscal Responsibility Act imposed an actuarial reduction on allowable benefits for those retiring before age 62 (subject to a $75,000 floor at age 55 or above). Four years later, the Tax Reform Act of 1986 imposed an actuarial reduction on anyone who retired before social security retirement age and eliminated the $75,000 floor for employees retiring at age 55. In 1997, the limit at age 55 was approximately $55,356, almost $20,000 less than the limit set in 1974. The reduction in limits for early retirement will become even more severe when the social security retirement age moves to age 66 and then to age 67.

The benefit limits are affecting the retirement security of increasing numbers of employees. Currently scheduled increases in the social security retirement age, as well as rapidly changing work arrangements, mean that early retirement programs will continue to be attractive and significant components of many employers' benefit plans.

Where an employer maintains only tax-qualified plans, employees whose benefits are restricted suffer a long-term loss of retirement benefits. Where the employer also maintains a nonqualified plan that supplements its qualified plan, employees might accrue full benefits, but the security and dependability of those benefits are substantially reduced. Since benefits under nonqualified plans are generally not funded, and are subject to the risk of the employer's bankruptcy, nonqualified plans receive virtually none of the protection that ERISA provides.

ERIC strongly supports the bill's provisions that improve retirement security by restoring the Internal Revenue Code limits to appropriate levels. ERIC is particularly appreciative of the bill's provisions that protect the benefits of early retirees. We urge prompt enactment of these provisions.

The bill (§ 101) restores the compensation limit to the level previously in effect. The Tax Reform Act of 1986 limited the amount of an employee's compensation that may be taken into account under a tax-qualified plan to $200,000 (indexed) per year. The Omnibus Budget Reconciliation Act of 1993 reduced the limit, which had since been indexed to $235,000, to $150,000. The Retirement Protection Act of 1994 slowed down future indexing by restricting indexing to increments of $10,000. The 1998 compensation limit is $160,000. If the Tax Reform Act limit had remained in effect, the limit would exceed $260,000.

Although the sharply reduced limit might appear to be aimed at the most highly paid employees, it has a substantial effect on employees much farther down the salary scale. In a defined benefit plan, the principal consequence of the reduced limit is to delay the funding of the plan. In plans where benefits are determined as a percentage of pay, projected pay increases are taken into account in funding the plan. This protects the plan and the employer from rapidly increasing funding requirements late in an employee's career.

However, the law does not allow an employer to anticipate future increases in the compensation limit; in other words, projected salary increases today are truncated at $160,000. The result is that funding of the plan is delayed -- not just for the highly paid but for workers earning as little as $40,000.

This restriction is particularly troublesome today since it delays funding for a very large cohort of workers: the baby boomers. The limit will result in higher contribution requirements for employees in the future. Some employers will not be able to make these additional contributions, and they may have to curtail the benefits under their plans.

In a § 401(k) plan, the nondiscrimination rules limit the amount that highly compensated employees may contribute on the basis of the contributions made by nonhighly compensated employees. For example, if the applicable limit is 6% of pay, a highly compensated employee earning $160,000 or higher will be able to contribute $9,600, which is virtually equal to the $10,000 limit that current law imposes on § 401(k) contributions. By contrast, a highly compensated employee earning $80,000 per year will be able to contribute only $4,800.

Increasing the dollar limit on compensation will have very little impact on the very highly compensated (who are already able to contribute at or near the dollar maximum). But it will permit the employees at the lower end of the highly compensated group, such as the employee earning $80,000 a year, to contribute substantially more to the plan.

ERIC strongly supports the bill's proposal to return the $160,000 limit to a $235,000 limit -- the limit in effect before the enactment of the Omnibus Budget Reconciliation Act of 1993.

The bill (§ 202) repeals the 25% of compensation limit on annual additions to a defined contribution plan. Under current law, the maximum amount that can be added to an employee's account in a defined contribution plan in any year is the lesser of $25,000 (indexed) or 25% of the employee's compensation. As a result of indexing, the $25,000 limit is now $30,000.

The 25% limit does not have a practical impact on a company's upper echelon employees. For example, for an employee earning $200,000 per year, the dollar limit is lower than the 25% limit.

Because of the 25% limit, employers can be forced to limit the contributions on behalf of lower-paid employees, especially employees who take advantage of the savings feature in a § 401(k) plan. Repealing the 25% limit will eliminate this problem.

Repealing the 25% limit also will benefit employees who want to increase their retirement savings at opportune times in their careers, including women who have reentered the work force after periods of child-rearing and others who need to catch up on their retirement savings.

Because of the dollar limit, the 25% limit is unnecessary and harmful to lower-income employees. It is particularly injurious to women and other workers who need to increase their retirement savings. ERIC strongly supports the bill's repeal of the 25% limit.

Other provisions. The bill makes other changes that will enable plan sponsors to design plans that meet the needs of their individual workforces. For example, section 504 contains modifications that will make the separate line of business rules of current law more workable. Today's separate line of business rules are so complex that many employers have given up trying to use them even though the companies involved have significantly diverse lines of business. The nature of today's business combinations and alliances differs significantly from just a decade ago, making it more important to have workable separate line of business rules. ERIC looks forward to studying this and other similar provisions in the bill in more detail.

Pension Portability

Employers and employees are increasingly involved in mergers, business sales, the creation of joint ventures, and other changes in business structure.[1] The bill promotes pension portability by eliminating a number of significant stumbling blocks to portability created by current law. The bill will substantially improve employees' ability to transfer their retirement savings from one plan to another and to consolidate their retirement savings in a single plan where they can oversee it and manage it effectively and efficiently.

The bill (§ 305) repeals the § 401(k) "same desk" rule. As a result of the sale of a business, an employee may transfer from the seller to the buyer but continue to perform the same duties

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[1] One large pension manager (T. Rowe Price) reported that 40% of the new plans that it set up in 1995 resulted from mergers, acquisitions, and divestitures.

as those that he or she performed before the sale. In these circumstances, under the § 401(k) "same desk" rule, the employee is not deemed to have "separated from service" and the employee's § 401(k) account under the seller's plan must remain in the seller's plan until the employee terminates employment with the buyer. This prevents the employee from rolling over his § 401(k) account to an IRA or consolidating it with his account under the buyer's plan.

Although current law (Internal Revenue Code § 401(k)(10)) provides some relief where the seller sells "substantially all of the assets of a trade or business" to a corporation or disposes of its interest in a subsidiary, the relief provided by current law is deficient in many respects. For example, in the case of an asset sale, the sale must cover "substantially all" the assets of the trade or business and the buyer must be a corporation. In some cases, it is not clear whether the "substantially all" standard has been met; in others, the transaction does not qualify as a sale; and in still other cases, the buyer is not a corporation.

More importantly, § 401(k) plans are the *only* tax-qualified plans that are subject to the "same desk" rule. *See* Attachment B.

As employees continue to change jobs over the course of their careers, it often is difficult for them to keep track of their accounts with former employers and difficult for former employers to keep track of former employees who may or may not remember to send in changes of address or otherwise keep in touch with their former employers' plans.

There is no justification for singling out § 401(k) plans for special restrictions on distributions in this way, and ERIC strongly supports the bill's repeal of the § 401(k) "same desk" rule.

The bill (§ 304) facilitates plan-to-plan transfers. Current Treasury regulations unnecessarily impair an employee's ability to transfer his or her benefits from one plan to another in a direct plan-to-plan transfer. The regulations provide that when a participant's benefits are transferred from one plan to another, the plan receiving the assets must preserve the employee's accrued benefit under the plan transferring the assets, including all optional forms of distribution that were available under the plan transferring the assets. The requirement to preserve the optional forms of benefit inhibits the portability of benefits because it reduces the willingness of plan sponsors to allow their plans to accept direct transfers from other plans.

The bill resolves this problem by providing that the plan receiving the assets does not have to preserve the optional forms of benefit previously available under the plan transferring the assets if the plan receiving the assets meets a series of requirements, including a requirement that the employee voluntarily elect to make the plan-to-plan transfer after having received full disclosure of the consequences of a transfer.

ERIC strongly supports this provision. The provision will encourage employers to permit plan-to-plan transfers and will allow employees to consolidate their benefits in a single plan where they can oversee and manage their retirement savings effectively and efficiently.

Section 304 also includes a provision allowing the elimination of optional forms of distribution in additional circumstances. We are currently analyzing this provision; after we have completed our analysis, we will be pleased to convey our views about this provision to the Subcommittee and its staff.

The bill (§ 303) allows an employee's after-tax contributions to be included in a rollover. Under current law, any portion of a distribution that is attributable to after-tax employee contributions is not eligible for rollover. This rule prevents employees who have made after-tax contributions from rolling over all of their benefits either to another plan or to an IRA. The rule unnecessarily and unwisely reduces the employee's retirement savings, and is inconsistent with the Congressional policy of encouraging employees to *preserve* their retirement savings. We applaud this provision of the bill, which will eliminate a provision of current law that not only is confusing to employees but forces them to strip a portion of their savings from their accounts just because the savings were made with after-tax contributions.

Rational Rules for Plan Administration

Superfluous, redundant, confusing and obsolete rules encumber the administration of tax-qualified retirement plans. These rules unnecessarily increase the cost of plan administration, discourage plan formation, and make retirement planning more difficult for employees. We are very pleased that H.R.3788 significantly advances the work Congress began in earlier bills to strip away these regulatory barnacles. For example:

The bill (§ 515) expands the 90-day notice period to one year. Under current law, a benefit with a present value exceeding $5,000 cannot be distributed in non-annuity form, or before the later of age 62 or normal retirement age, without the participant's consent. In addition, a plan administrator must give the recipient of an eligible rollover distribution a written explanation of certain tax rules within a reasonable period of time before making the distribution.[2]

Treasury regulations provide that a participant's consent to receive an early distribution is not valid unless the participant first receives in writing certain information concerning both (1) optional forms of benefit and (2) his or her right to defer receipt of the distribution. Under the regulations, the information must be provided no more than 90 days before the distribution. Treasury regulations also provide that the description of the tax rules for eligible rollover distributions will satisfy the reasonable time period requirement if the information is provided within 90 days before the distribution.[3]

There is no statutory basis for the 90-day rule that appears in the current Treasury regulations. The 90-day rule impairs the ability of plan administrators to administer their plans efficiently and effectively and interferes with employees' ability to make withdrawals from their plans. The following two examples illustrate this point:

> **Mary** has been discussing retirement with her husband for several months. In early November she requested and received a retirement package (including the written notice regarding her benefit options). On March 3 she comes to the Benefits Department to sign retirement elections for April 1. Since Mary received the required information on benefit options more than 90 days previously, the Benefits Department must send her a new package before it can implement Mary's request. Mary complains that she already has enough paperwork without receiving duplicate packages. She does not understand why she has to receive a new package when she already has one. She thinks it is a waste of her retirement plan's money.
>
> **George** has been laid off. He will receive severance payments for six months and then will receive a distribution from his former employer's profit-sharing plan. Although full information was provided to George when he left the company, information on the profit-sharing distribution must be sent to him again within 90 days of the distribution from the plan. George is confused by the information and is critical of his former employer for sending duplicative benefits information.

As these examples illustrate, the 90-day rule is excessive, expensive, and effectively irrelevant to the employee's decision-making process. The one-year period required by the bill will achieve the objective of giving employees timely information, without imposing the excessive costs and compliance burdens imposed by the current regulations. ERIC strongly supports this provision of the bill.

The bill (§ 507) repeals the unnecessary and inadministrable IRS look-back rule. Under current law, a pension or profit-sharing plan, including a § 401(k) plan, may provide that if, following a participant's termination of employment, the value of the participant's benefit does not exceed $5,000,

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[2] *See* Int. Rev. Code §§ 411(a)(11), 417(e), 402(f).

[3] *See* Treas. Reg. §§ 1.411(a)-11T(c)(2), 1.417(e)-1T(b)(3), 1.402(f)-1, Q&A-2.

the plan may distribute the benefit in a lump-sum without the participant's consent. This is a rule of convenience that allows plans to eliminate the cost of preserving small benefits by distributing the present value of those benefits in immediate lump sums.

The Treasury regulations, however, complicate this rule by superimposing a look-back rule. The look-back rule states that if the value of the participant's benefit at the time of any distribution to the participant exceeds the mandatory lump-sum limit, the value at any subsequent time is also deemed to exceed the limit -- regardless of whether the value of the participants benefit at that subsequent time is below the limit.[4]

For example, if a plan allows hardship distributions, the plan administrator must review its records to determine whether the participant has ever received a hardship distribution and to determine the value of the participant's benefit at the time of any prior hardship distribution. This can be particularly difficult and costly for any plan, and especially when plans sponsored by other employers have merged into the plan (perhaps as a result of corporate mergers and acquisitions), and the current plan sponsor does not possess the historical records of the merging plans. The cost of making these determinations greatly exceeds any benefit that the look-back rule might be deemed to provide.

The look-back rule is contained only in Treasury regulations. It was not enacted by Congress. Indeed, it did not appear until the Treasury issued revised *final* regulations in 1988. It did not appear in the original final regulations that the Treasury issued in 1977 or even in the temporary regulations that the Treasury issued in 1985. Thus, the look-back rule was never subject to the customary public notice and comment procedure.

The mandatory lump-sum provisions are designed to allow plans to reduce their administrative costs by making lump-sum payments to participants with small benefits. The Treasury's look-back rule defeats that objective in two ways: it makes it more costly for administrators to determine whether the lump-sum provisions apply; in addition, the look-back rule can prevent a plan from relying on the lump-sum provisions in many cases where the value of the participant's current benefit is well below $5,000.

ERIC strongly supports the bill's repeal of the look-back rule.

Reducing Regulatory Burdens

The bill (§ 501) changes the way in which the qualification standards are enforced. Under current law, a plan can be disqualified for failing to meet the Internal Revenue Code's qualification requirements even if the failure was inadvertent and even if the employer has made a good faith effort to administer the plan in accordance with the qualification requirements. ERIC has long been concerned with this serious problem, and it is very appreciative of the interest that the sponsors of H.R.3788 have taken in this issue.

ERIC advocates an enforcement policy that emphasizes correction over sanction; that encourages employers to administer their plans in accordance with the qualification standards; that encourages employers to remedy promptly any violations they detect; that reserves IRS involvement for serious violations; and that applies appropriate sanctions only where employers fail to remedy serious violations that they are aware of.

During the past several years ERIC and other interested parties have worked with the Treasury Department and the Internal Revenue Service on the development and improvement of the Service's Employee Plans Compliance Resolution System ("EPCRS"), which includes, among other things, the Service's Administrative Policy Regarding Sanctions ("APRSC"). In formulating and improving EPCRS and APRSC, the Treasury and the Service have been very responsive to the concerns expressed by ERIC and other groups. We are currently working with the Treasury and the Service on improvements to EPCRS.

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[4] *See* Treas. Reg. §§ 1.411(a)-11(c)(3), 1.417(e)-1(b)(2)(i).

Although we believe that improvements can and should be made in EPCRS, we believe that improvements are best made at an administrative level, where changes can readily be made to respond to changing circumstances and to newly-identified issues. If the Subcommittee believes that legislation is necessary, we suggest that the legislation encourage the Treasury and the Service to expand and improve their existing program and that the legislation not lock the program into specific terms and conditions that can be changed only by legislation. We will be pleased to discuss this matter further with the Subcommittee, and, again, appreciate very much the interest this body has shown in this most important area.

That completes my prepared statement. I would like to thank the Chair and the Subcommittee for giving ERIC the opportunity to testify. I will be happy to respond to any questions that the members of the Subcommittee might have.

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ATTACHMENT A

A Historical Summary of Limits Imposed on Qualified Plans

1. **IRC §415(b) limit of $120,000 on benefits that may be paid from or funded in defined benefit (DB) plans.** Prior to ERISA, annual benefits were limited by IRS rules to 100% of pay. ERISA set a $75,000 (indexed) limit on benefits and on future pay levels that could be assumed in pre-funding benefits. After increasing to $136,425, the limit was reduced to $90,000 in TEFRA (1982). It was not indexed again until 1988; and it was subjected to delayed indexing, i.e., in $5000 increments only, after 1994 (RPA). RPA also modified the actuarial assumptions used to adjust benefits and limits under §415(b). The limit for 1997 is $125,000. If indexing had been left unrestricted since 1974, the limit for 1997 would be approximately $218,000.

2. **IRC §415(b) defined benefit limit phased in over first ten years of service.** ERISA phased in the $75,000 limit over the first ten years of service. This was changed to years of participation in the plan (TRA '86).

3. **IRC §415(b) early retirement limit.** Under ERISA, the $75,000 limit was actuarially reduced for retirements before age 55. TEFRA imposed an actuarial reduction for those retiring before age 62 (subject to a $75,000 floor at age 55 or above); and TRA '86 imposed the actuarial reduction on any participant who retired before social security retirement age and eliminated the $75,000 floor. For an employee retiring at age 55 in 1997, the limit (based on a commonly-used plan discount rate) is approximately $55,356. The early retirement reduction will become even greater when the social security retirement age increases to age 66 and age 67.

4. **IRC §415(c) limit of $30,000 on contributions to defined contribution (DC) plans.** ERISA limited contributions to a participant's account under a DC plan to the lesser of 25% of pay or $25,000 (indexed). The $45,475 indexed level was reduced to $30,000 in TEFRA (1982); indexing also was delayed by TRA '86 until the DB limit reached $120,000. RPA restricted indexing to $5000 increments. The 1997 limit is still $30,000. If indexing had been left unrestricted since 1974, the 1997 limit would be approximately $72,500.

5. **IRC §415(c) limit of 25% of compensation on contributions to defined contribution plans.** Prior to ERISA, the IRS had adopted a rule of thumb whereby contributions of up to 25% of annual compensation to a defined contribution plan generally were acceptable. ERISA limited contributions to a participant's account under a DC plan to the lesser of 25% of pay or $25,000 (indexed). Section 1434 of Public Law 104-188 alleviates the more egregious problems attributed to the 25% limit for nonhighly compensated individuals by including an employee's elective deferrals in the definition of compensation used for §415 purposes. Public Law 105-34 alleviates an additional problem by not imposing a 10% excise tax on contributions in excess of 25% of compensation where the employer maintains both a defined benefit and defined contribution plan and the limit is exceeded solely due to the employee's salary reduction deferrals plus the employer's matching contribution on those deferrals.

6. **Contributions included in the IRC §415(c)'s defined contribution plan limit.** ERISA counted against the DC limit all pre-tax contributions and the lesser of one-half of the employee's after-tax contributions or all of the employee's after-tax contributions in excess of 6% of compensation. TRA '86 included *all* after-tax contributions.

7. **IRC §415(e) combined plan limit.** Under ERISA, a combined limit of 140% of the individual limits applied to an employee participating in both a DB and a DC plan sponsored by the same employer. E.g., if an employee used up 80% of the DC limit, only 60% of the DB limit was available to him or her. TEFRA reduced the 140% to 125% for the dollar limits. Section 1452 of Public Law 104-188 repeals the combined plan limit beginning in the year 2000.

8. **IRC §401(a)(17) limit on the amount of compensation that may be counted in computing contributions and benefits.** TRA '86 imposed a new limit of $200,000 (indexed) on compensation that may be taken into account under a plan. OBRA '93 reduced the $235,000 indexed level to $150,000. RPA restricted future indexing to $10,000 increments. The 1997 limit is $160,000. If this limit had been indexed since 1986 without reduction the 1997 level would be $261,560.

9. **IRC §401(k)(3) percentage limits on 401(k) contributions by higher paid employees.** Legislation enacted in 1978 that clarified the tax status of cash or deferred arrangements also imposed a limit on the rate at which contributions to such plans may be made by highly compensated employees. TRA '86 reduced this percentage limit. Section 1433 of Public Law 104-188 eliminates this requirement for plans that follow certain safe-harbor designs, beginning in the year 1999.

10. **IRC §401(m)(2) percentage limits on matching contributions and after-tax employee contributions.** TRA '86 imposed a new limit on the rate at which contributions may be made on behalf of HCEs.

Beginning in the year 1999, section 1433 of Public Law 104-188 eliminates this requirement for matching payments on pre-tax (but not after-tax) elective contributions of up to 6% of pay if those payments follow certain safe-harbor designs.

11. **IRC §402(g) dollar limit on contributions to 401(k) plans.** TRA '86 imposed a limit of $7000 on the amount an employee may defer under a 401(k) plan. RPA restricted further indexing to increments of $500. The indexed limit is now $9,500.

12. **IRC §4980A - 15% excise tax on "excess distributions."** TRA '86 imposed an excise tax (in addition to applicable income taxes) on distributions in a single year to any one person from all plans (including IRAs) that exceed the greater of $112,500 (indexed) or $150,000 (or 5 times this threshold for certain lump-sum distributions). RPA restricted indexing to $5000 increments. The limit was indexed to $160,000 in 1997. In addition, TRA '86 imposed a special 15% estate tax on the "excess retirement accumulations" of a plan participant who dies. Section 1452 of Public Law 104-188 provides a temporary suspension of the excise tax (but not of the special estate tax) for distributions received in 1997, 1998, and 1999. Public Law 105-34 permanently repeals both the excess distributions tax and the excess accumulations tax, for distributions or deaths after 12-31-96.

13. **IRC §412(c)(7) funding cap.** ERISA limited deductible contributions to a defined benefit plan to the excess of the *accrued* liability of the plan over the fair market value of the assets held by the plan. OMBRA (1987) further limited deductible contributions to 150% of the plan's *current* liability over the fair market value of the plan's assets. Public Law 105-34 gradually increases this limit to 170%.

14. **ERISA §3(36) definition of "excess benefit plan."** ERISA limited excess benefit plans to those that pay benefits in excess of the IRC §415 limits. Other nonqualified benefits must be paid from "top hat" plans under which participation must be limited to a select group of management or highly compensated employees.

LEGEND:

ERISA -- Employee Retirement Income Security Act of 1974
HCE -- highly compensated employee
IRC -- Internal Revenue Code
IRS -- Internal Revenue Service
OBRA '93 -- Omnibus Budget Reconciliation Act of 1993 (P.L.103-66)
OMBRA -- Omnibus Budget Reconciliation Act of 1987 (P.L.100-203)
P.L.104-188 -- The Small Business Job Protection Act of 1996
P.L.105-34 -- The Taxpayer Relief Act of 1997
RPA -- The Retirement Protection Act of 1994 (included in the GATT Implementation Act, P.L.103-465)
TEFRA -- The Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248)
TRA '86 -- The Tax Reform Act of 1986 (P.L. 99-514)

ATTACHMENT B

APPLICATION OF SAME DESK RULE TO PAYMENTS FROM TAX-QUALIFIED PLANS

Type of Plan	Does Same Desk Rule Apply?
Conventional Defined Benefit Pension Plan	No
Cash Balance Pension Plan	No
Money Purchase Pension Plan	No
Profit-Sharing Plan	No
Stock Bonus Plan	No
Employee Stock Ownership Plan	No
Employer Matching Contributions	No
After-Tax Employee Contributions	No
§ 401(k) Contributions	Yes[5/]

[5/] The same desk rule also applies to § 403(b) and § 457(b) plans, which are nonqualified plans sponsored by governmental and tax-exempt employers.

Chairman JOHNSON of Connecticut. Thank you, Mr. Porter.

Mr. Salisbury.

STATEMENT OF DALLAS L. SALISBURY, PRESIDENT AND CEO, EMPLOYEE BENEFIT RESEARCH INSTITUTE AND PRESIDENT AND CEO, AMERICAN SAVINGS EDUCATION COUNCIL

Mr. SALISBURY. Chairman Johnson and Congressman Coyne, members of the committee—it's a pleasure to be here today. I want to provide my formal focus on retirement savings education which began between the Department of Labor and EBRI in meetings in 1994. By July 1995, the Department of Labor, and the Treasury Department with Members of Congress launched a retirement savings education campaign with numerous public and private sector partners.

One part of that campaign was the creation of the American Savings Education Council which includes over 14 Federal agencies, Members of Congress, and 250 private sector organizations. That campaign, as the congressman mentioned, has led to the creation and dissemination of millions of copies of a Top 10 Ways to Save brochure and numerous others available through both an 800 number and a website at the Department of Labor. The American Savings Education Council has put out a Power to Choose brochure, a Ballpark retirement income estimator, and, again, makes much available through its website.

The Securities and Exchange Commission sponsored a full week on facts on Saving and Investing, with many public and private partners in national teleconferences with extensive savings education materials and planning materials now available through the SEC website and an 800 number.

The Jumpstart Coalition brings together over 250 public, and private organizations focused exclusively on bringing financial literacy and early savings education to young adults, and Girl Scouts, USA is doing the same within the Girl Scout program. Most of these organizations have linked websites and numerous 800 numbers to take information out with one ultimate purpose in the hope that individuals will save and prepare for retirement at very early ages and will ask, frankly, their employers to help them do so and encourage their employers to create retirement savings opportunities.

Last fall, the Congress on a bipartisan basis acted to pass the SAVER Act calling for a national summit on retirement income savings. That summit will be held here in Washington, D.C. on June 4th and 5th. Leading up to that summit, EBRI and ASEC, this fall, launched a Choose to Save media campaign in the Washington, DC area with WJLA channel 7 and eight local radio stations to take public service announcements on savings education to the broad population of the three-State metro area. That will be complimented by contributed space print ads throughout the metro system during the month of June and is being run across the Nation in public service announcements on Associated Press radio, 75 all-news stations.

EBRI has just completed a health confidence survey looking at issues of retiree health savings for retiree health. For the SAVER Summit, we have just completed a new retirement confidence survey and also an extensive national survey of small employer retire-

ment programs and small employer attitudes towards why they either have programs or what has kept them from creating pension programs, both of which will be released just prior to the summit on June 2.

ASEC is quite proud to be the primary private sector partner on the summit contributing substantially to the financing; preparing draft agendas and briefing books, and I want to publicly recognize the American Society of Pension Actuaries for their invaluable assistance to the Nation in doing the negotiating and managing of the logistics for the summit.

The June 4 and 5 SAVER Summit will bring together 239 delegates from both political parties and from all sectors to build an action agenda for educating the American public and American employers to the absolute necessity of moving towards planning and saving and the creation of retirement plans. No more than 20 percent of all workers will ever work under one defined benefit pension plan long enough to get a sufficient, substantial pension. For 80 percent that do not work a full career with one employer, the only hope of adequate supplementation is individual savings helped through their employment situation with preservation and rollover.

First, consider the fact that two-thirds of retirees have little from the sources just mentioned which underlines the need for saving and retirement planning education. Then consider the fact that Congress has already acted to raise the eligibility age under Social Security to 67 which will make that savings through employer plans and individual effort all the more important.

In closing, I congratulate the Oversight Subcommittee for its ongoing work on this important topic. I first appeared before this subcommittee on pension issues 22 years ago and have always found it to be focused on providing a framework for policies that will enable Americans and American employers to fulfill the dream of a comfortable retirement. Thank you.

[The prepared statement follows:]

T-112

Statement

Before the

Committee on Ways and Means
Subcommittee on Oversight
U.S. House of Representatives

Hearing on

Oversight of Various Pension Issues
by

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Testimony Summary

- Government is grappling with mounting financial pressures on the Social Security system. Employers, encountering competitive forces and trying to manage a diverse work force, are revamping traditional pension programs. These forces underscore the need for individuals to play a major role in providing for their own retirement. Fortunately, individuals have more opportunities than ever to save for themselves, either through work-based retirement-savings plans or through tax-deferred individual retirement accounts (IRAs). For a variety of reasons, however, many people have failed to take full advantage of these tools.

- As a first step toward building public understanding of the retirement-savings issue we need to clarify what today's workers can expect from government and employers concerning retirement, and what individuals must demand of themselves. The simple fact is that for most people, Social Security and employment-based pensions alone do not provide everything that is needed for a secure retirement—and they surely won't suffice in the future.

- Numerous public and private agencies have joined forces to help Americans prepare financially for retirement. These diverse partners have created and field-tested many of the resources that will be needed to make saving a national priority in the years ahead.

- The Employee Benefit Research Institute (EBRI) and its American Savings Education Council (ASEC) affiliate, have developed "Choose to Save ™," a media campaign for spreading the word about retirement savings. In its inaugural effort, EBRI and ASEC joined forces with one television station and three radio stations in Washington, D.C., to air a series of paid public service announcements urging people to save for retirement. The campaign will culminate in a prime time news special to be broadcast Friday, June 12, 1998.

- EBRI and ASEC also sponsor, with Mathew Greenwald Associates, the Retirement Confidence Survey, an annual survey of American workers' and retirees' attitudes and behavior concerning retirement saving and planning. This year's survey is scheduled for release June 2, 1998.

- Separately, the U.S. Department of Labor (DOL) and the U. S. Department of Treasury launched a Retirement Savings Education Campaign in July, 1995. One part of the campaign, a unique public-private sector partnership, was the creation of the American Savings Education Council. The campaign's signature brochure, "Top Ten Ways to Beat the Clock and Prepare for Retirement," describes basic steps individuals should take to ensure their financial security.

- A broad coalition of government, business and consumer organizations has launched a grassroots education project called the Facts on Saving and Investing Campaign. The campaign's slogan: "Get the facts. It's your money. It's your future." Spearheaded by the Securities and Exchange Commission, the campaign published "The Facts on Saving and Investing," which explains the need for increased financial literacy. The campaign also has assembled a "Financial Facts Tool Kit," which includes a variety of educational materials on how to get started in developing a financial plan, how to understand investment choices, how to manage money and investments, and how to get more information on saving and investing.

- A number of programs seek to increase financial awareness among young people and children. The Jump$tart Coalition, a group of about 20 federal agencies, universities and non-profit associations, seeks to improve understanding of personal finance among young adults. Separately, the American Bankers Association sponsors an annual "National Teach Children to Save Day," in which bankers around the country visit elementary schools to teach children about the importance of saving money. Last year, more than 2,500 bankers made 5,000 presentations to 125,000 students. Observing that many women are more economically vulnerable than men, the Girl Scouts of the U.S.A. have developed "Money Smarts," a comprehensive personal finance project and resource guide for girls.

- The Pension Benefit Guaranty Corporation, which ensures that more than 42 million workers who are enrolled in 50,000 defined benefit pension plans have some pension protection, publishes "Your Guaranteed Pension."

Testimony

Chairman Johnson and members of the Subcommittee, my name is Dallas Salisbury. I am President and CEO of the Employee Benefit Research Institute (EBRI) and also serve as Chairman and CEO of an affiliated organization, the American Savings Education Council (ASEC). It is a pleasure to be here this afternoon to discuss pension and retirement income savings issues. I first had the privilege of appearing before this Subcommittee 22 years ago, and congratulate the Committee on its longstanding work toward strengthening the American retirement system.

EBRI's mission is to contribute to, to encourage, and to enhance the development of sound employee benefit programs and sound public policy through objective research and education. EBRI does not lobby and does not take positions for or against legislative proposals. ASEC's goal is to make saving and planning a vital concern of Americans.

Since 1978, EBRI has conducted hundreds of studies that have documented the important role of pensions in our retirement income system. Our work on small employers and pensions underlines the importance of administrative simplicity, contribution flexibility, and rules that can be clearly understood by the average plan participant. This Committee has taken steps in recent years to make plans more approachable for small employers, and I commend you for continuing that important work. Later this month we will complete analysis of our 1998 Small Employer Retirement Survey (SERS), and I will make our findings available to the Committee at that time. I am hopeful that these findings will assist your efforts to increase small employer sponsorship and coverage rates.

Last year, Congress recognized the need for retirement education with the passage of the Savings Are Vital to Everyone's Retirement Act of 1997 (SAVER). The Act, as you know, aimed to increase efforts to educate Americans about the importance of saving and planning for retirement. Signed by President Clinton on November 20, 1997, SAVER called for the White House/Congressional National Summit on Retirement Savings to spearhead a broad-based public effort involving both the public and private sectors in helping Americans achieve their dreams for a financially secure retirement. Follow-up summits in 2001 and 2005 will gauge our progress and explore new issues and strategies.

Government, bracing for the retirement of the baby boom generation, is grappling with mounting financial pressures on the Social Security system. Employers, encountering competitive forces and trying to manage a diverse work force, are revamping traditional pension programs.

These forces underscore the need for individuals to play a major role in providing for their own retirement. Fortunately, individuals have more opportunities than ever to save for themselves, either through employment-based retirement savings plans or through tax-deferred individual retirement accounts (IRAs). For a variety of reasons, however, many people have failed to take full advantage of these tools.

As a first step toward building public understanding of the retirement savings issue, then, we need to clarify what today's workers can expect from government and employers concerning retirement, and what individuals must demand of themselves. The simple fact is that, for most people, Social Security and employment-based retirement plans alone do not provide everything that is needed for a secure retirement—and they surely won't suffice in the future.

How Do Individuals View Retirement?

While the evidence is compelling that individuals must carry a substantial part of the burden of providing for their own retirement, many people seem almost willfully ignorant of what they must do to make their retirement dreams a reality. How can we understand this pervasive lack of planning and saving in the face of our strong desire for a comfortable and secure retirement? In 1995, the Widmeyer Group convened a series of focus groups to explore how individuals view retirement-planning issues. It found a public that is troubled and hungry for reliable information but unsure of where to turn for help.

"Caught between expectations and current realities," many of the focus group participants look to the future with "grand hopes and deep fears," Widmeyer reported. "Retirement for many may be the number one savings priority, but it is not immediately pressing and is therefore the easiest item to put off."

When forced to face the issue—for instance, when shown how much they will need to save each year to be able to provide themselves an adequate income—most people "listened intently and then appeared truly alarmed, taken aback, and even depressed." But they don't know what to do about their concerns.

"Participants almost unanimously expressed interest in obtaining positive, practical, and concrete information," Widmeyer said. But "they don't know where to turn, whom to trust, and how to proceed. They want to find a credible financial advisor, but they are wary of people who stand to gain from their savings. They are also scared by the complexity of certain financial information."

The challenge of SAVER, then, is to find ways to channel such fears and uncertainty into constructive planning for the future. But first, we must assess where we stand today when it comes to preparing for retirement.

If workers are to assume more personal responsibility for providing for themselves in retirement, they must understand at least the basics of saving and investing.

A number of surveys have shown, however, that many lack the knowledge they need to be effective investors. In 1996, the Retirement Confidence Survey found that only one-third of workers have a high degree of financial knowledge, while 55% have a moderate level and 11% have a very low level of knowledge. The survey found, in particular, that:

- Only 44% of those polled knew that a male retiring today at age 65 can expect to live to age 80, on average.
- 61% knew that the U.S. stock market has provided a greater return over the past 20 years than U.S. government bonds.
- Just 53% knew that employer stock typically is more volatile than a diversified portfolio of stocks.
- Only one-half knew that the probability of losing money on an investment goes down the longer one holds the investment.
- Fully 86% knew that the average person retiring today will need 60%–80% of his or her working income to maintain the same standard of living.

In February 1997, the National Association of Securities Dealers Inc., (NASD) reported survey results showing that, while 63% of Americans know the difference between a halfback and a quarterback, only 14% can distinguish between a growth stock and an income stock. Moreover, NASD said, while 78% can name a character on a television situation comedy, only 12% know the difference between a "load" and "no-load" mutual fund.

Not surprisingly given such findings, some individuals fail to follow basic rules about diversifying their portfolios, and many appear to invest too conservatively. Surveys by Hewitt Associates and the Profit Sharing/401(k) Council of America suggest, for instance, that between one-quarter and one-third of all retirement plan assets are invested in stock issued by the participants' employers. (In some cases, this may not reflect the plan participants' decisions, however. Frequently, employers only make matching contributions in the form of company stock).

In a 1996 study of the retirement plans of three large companies, EBRI found that even though equity investments have consistently outperformed other kinds of investments over long periods of time, anywhere from 17%-34% of plan participants under age 39 had invested none of their funds in stock.

Many people are concerned about their own lack of understanding when it comes to managing their retirement funds. The 1997 Retirement Confidence Survey found that while 44% of the people who are saving for retirement are very confident that they are investing wisely, 48% are only somewhat confident. What's more, 31% said they do not enjoy making investment decisions about retirement savings. The survey contains a core set of questions that is asked annually and is used to track key attitudes and behavior patterns over time. The 1998 survey is scheduled for release June 2, to coincide with the National Summit on Retirement Savings.

Financial Education Activities

How, then, can we give today's workers the knowledge and help they need to make sure their retirement savings will grow enough to meet their future needs?

Numerous public and private agencies have joined forces to help Americans prepare financially for retirement. These diverse partners have created and field-tested many of the resources that will be needed to make saving a national priority in the years ahead.

EBRI and its affiliate ASEC have developed "Choose to Save™," a public service media campaign to spread the word about retirement savings. In its inaugural effort, EBRI and ASEC joined forces with one televi-

sion station and three radio stations in Washington, DC, to air a series of paid public service announcements urging people to save for retirement.

WJLA-7, the local ABC affiliate, produced the television announcements. Specific advertisements were geared to each of the three major groups—"strugglers," "impulsives," and "deniers"—who currently are failing to save enough for retirement. The campaign also touted the "Ballpark Estimate," a one-page form ASEC developed that enables individuals to make quick and easy estimates of what they will need to save and invest each year to meet their retirement objectives.

WJLA-7 also prepared its own weekly news stories on the retirement savings issue, and hosted two town hall meetings, portions of which will be included in a prime-time news special to be aired Friday, June 12.

The Washington area Choose to Save™ campaign was underwritten by Fidelity Investments. The public service announcements are generic, and are available for use in other media markets.

ASEC's Web site, which includes an interactive version of the Ballpark Estimate along with other retirement-related resources, is <www.asec.org>. The Choose to Save™ Campaign maintains its own Web site at <www.choosetosave.org>. The EBRI Web site is <www.ebri.org>.

Separately, the U.S. Department of Labor (DOL) and the U. S. Department of Treasury launched a Retirement Savings Education Campaign in July 1995. One part of the campaign, a unique public-private sector partnership, was the creation of ASEC. The campaign's signature brochure, "Top Ten Ways to Beat the Clock and Prepare for Retirement," describes basic steps individuals should take to ensure their financial security. It also recommends a number of other informational resources.

DOL also offers two other publications that give workers information about their pensions: "What You Should Know About Your Pension Rights" and "Protect Your Pension."

These and other publications are available through the agency's toll-free Publication Hotline 1-800-998-7542 and on the Internet at <www.dol.gov/dol/pwba>.

In April 1998, a broad coalition of government, business, and consumer organizations launched a grassroots education project called the Facts on Saving and Investing Campaign. The campaign's slogan is "Get the facts. It's your money. It's your future."

Spearheaded by the Securities and Exchange Commission (SEC), the campaign published "The Facts on Saving and Investing," which explains the need for increased financial literacy. The campaign also has assembled a "Financial Facts Tool Kit," which includes a variety of educational materials on how to get started in developing a financial plan, how to understand investment choices, how to manage money and investments, and how to get more information on saving and investing.

The SEC also holds periodic investor town meetings aimed at increasing financial literacy. At a recent town meeting in Connecticut, for instance, SEC Chairman Arthur Levitt conveyed basic tips to investors on how they can make informed decisions, monitor their current investments, and avoid investment problems. U.S. Senators Christopher J. Dodd and Joseph I. Lieberman addressed issues before Congress affecting individual investors. Connecticut's Banking Commissioner John P. Burke described individual investor protection efforts in the State of Connecticut. In addition, there were seminars following the town meeting, including one entitled "Women and Retirement: The Difficult Road Ahead" presented by ASEC and The National Center for Women and Retirement Research.

More information on SEC activities is available at the agency's Web site <www.sec.gov>, or by calling 1-800-732-0330. The Alliance for Investor Education also maintains a Web site on the Facts on Saving and Investing Campaign at <www.investoreducation.org>. Individuals who want more information or are seeking help because they have had trouble with an investment can write to the Office of Investor Education and Assistance, Mail Stop 11-2, 450 Fifth Street, NW, Washington, DC 20549.

One useful tool included in the Financial Facts Tool Kit is *The Consumer's Almanac*. Developed by the American Financial Services Association (AFSA), this 32-page booklet is designed to help individuals organize their finances, incorporate long-range goals such as financing retirement or paying for children's education into family budgets, and manage credit wisely. Information is available from the AFSA Education Foundation at <www.afsaef.org> or (202) 223-0321.

A number of programs seek to increase financial awareness specifically among young people and children.

The Jump$tart Coalition, a group of about 20 federal agencies, universities, and non-profit associations, seeks to improve understanding of personal finance among young adults. The coalition's initiatives fall into three

broad categories.

First, the coalition is evaluating current and future levels of financial literacy among young adults. An initial baseline survey, administered to 1,500 twelfth graders in March and April 1997, showed a serious lack of knowledge about personal financeæstudents scored, on average, just 57.9%. Less than 15% said stocks are likely to have the highest growth over 18 years, while over one-half (54.7%) said a U.S. Government savings bonds would and one-quarter (27.8%) said savings accounts would. Over one-half (51%) said bank certificates of deposit are not protected by the federal government against loss, and nearly 20% thought U.S. Savings or Treasury Bonds are not protected. Nearly a one-third (30%) said retirement income received from a company is called Social Security. Similar tests will be repeated every two years for the next decade to determine whether students' knowledge is increasing.

Second, the coalition is disseminating teaching guidelines for grades K-12. Over 20 representatives from elementary schools, middle schools, business, and others provided written advice on the guidelines. In addition, a panel of five teachers from across the United States provided additional input for the guidelines based on their classroom experiences.

Third, the coalition is operating a national clearinghouse that can serve as a one-stop source for high-quality teaching materials that will help educators teach the skills covered by the coalition's guidelines. The information will be disseminated primarily via the World Wide Web, but print materials also will be available via mail, telephone, and direct contact at exhibits, seminars, and conferences.

More information about the Jump$tart Coalition can be obtained by contacting the American Financial Services Association Education Foundation at (202) 296-5544. The coalition's Internet address is <www.jumpstartcoalition.org>.

Separately, the American Bankers Association sponsors an annual "National Teach Children to Save Day," in which bankers around the country visit elementary schools to teach children about the importance of saving money. Last year, more than 2,500 bankers made 5,000 presentations to 125,000 students. The American Bankers Association Education Foundation can be reached at 1-800-338-0626, and it maintains a Web site at <www.aba.com>.

Observing that many women are more economically vulnerable than men, Girl Scouts of the U.S.A. has developed "Money Smarts," a comprehensive personal finance project and resource guide for girls. Inquiries should be directed to Membership and Program, Girl Scouts of the U.S.A., 420 Fifth Avenue, New York, N.Y. 10018-2702.

Girls Inc., a research, advocacy, and educational organization, also is developing a money management curriculum for girls. The project is supported in part by $50,000 in profits donated by OppenheimerFunds from its book, *A Woman's Guide to Investing*.

The latter project was developed after a nationwide survey of 522 women conducted in March 1997 showed that 41% said learning about investing and money management is one of the most important skills a girl can acquire. Only 6% of the women felt they were very knowledgeable about investing, and 56% said they were not very knowledgeable.

Girls Inc. is based in New York, and can be reached at 212-689-3700 or via the World Wide Web at <www.girlsinc.org>.

The Pension Benefit Guaranty Corporation (PBGC), which ensures that more than 42 million workers who are enrolled in 50,000 defined benefit pension plans have some pension protection if their employers have financial difficulty and cannot fund pension plans or pay promised benefits, has published *Your Guaranteed Pension*. The publication can be obtained by writing to PBGC, 1200 K Street, NW, Washington, DC, 20005-4026 or calling (202) 326-4000. The agency's Internet address is <www.pbgc.gov>.

The Cooperative State Research, Education and Extension Service, U.S. Department of Agriculture, offers educational programs in personal finance with an emphasis on saving for retirement, through partner universities and county offices nationwide. Contact your local Cooperative Extension office, often located in courthouses, post offices, or other government buildings. The Internet address is <www.reeusda.gov/statepartners/usa.htm>.

The Internal Revenue Service has many resources to help taxpayers understand financial issues facing them in retirement. One good starting place is Publication 910, *Guide to Free Tax Services*. This and other publications can be ordered by calling 1-800-TAX-FORM (1-800-329-3676). The TTY/TDD number is 1-800-829-4059. The Internet address is <www.irs.ustreas.gov>.

The General Services Administration offers many free and low-cost publications about retirement plan-

ning. For the agency's free *Consumer Information Catalog*, call 1-888-878-3256, or write "Consumer Information Catalog," Pueblo, Colo., 81009. The Internet address is www.pueblo.gsa.gov.

The U.S. Federal Trade Commission offers advice on how to guard against fraudulent investment schemes. Write or call: Consumer Response Center, Federal Trade Commission, Washington, DC 20580, (202) 326-2222 or TDD (202) 326-2502 or visit the agency's Web site at <www.ftc.gov>.

Conclusion

No one can deny that Social Security provides the primary source of income today for over two-thirds of all retired Americans. For those no longer working, employment-based defined benefit pensions, employment-based defined contribution pensions, and individual savings outside of any tax-deferred arrangement, or through an IRA, provide additional cash income to supplement Social Security.

No more than 20 percent of all workers will ever work under one defined benefit pension plan long enough to get a sufficiently substantial pension to fully supplement Social Security. For the other 80 percent, the only hope of adequate supplementation is individual savings, hopefully with the added contributions of an employer to a money purchase pension plan, a 401(k), a 403(b), or some other type of defined contribution arrangement. First, consider the fact that two-thirds of retirees have little from the sources just mentioned, which underlines the need for education.

Then, consider the fact that Congress has already acted to raise the age for full retirement benefits under Social Security from age 65 to age 67, and the fact that more will have to be done to assure the system's future viability.

These facts combine to tell us that anything we can do as a nation to encourage employers to do more to provide pensions of any type, and to educate workers, should be done if we continue to have the policy objective of allowing individuals to retire with dignity.

I congratulate the Oversight Subcommittee for its ongoing work on this important topic. As previously mentioned, I first appeared before this Subcommittee in 1976, some 22 years ago, and I have always found it to be focused on providing a framework of policy that will allow Americans to fulfill the dream of a comfortable retirement. You have continued that positive movement today, and I thank you for allowing me to be a part of this hearing.

Chairman JOHNSON of Connecticut. Thank you very much.

Ms. Calimafde.

STATEMENT OF PAULA A. CALIMAFDE, CHAIR, SMALL BUSINESS COUNCIL OF AMERICA AND SMALL BUSINESS LEGISLATIVE COUNCIL, BETHESDA, MARYLAND

Ms. CALIMAFDE. Madam Chair and Members of the Committee, it's a pleasure to be here today. I'm Paula Calimafde, Chair of the Small Business Council of America. Also, I'm here on behalf of the Small Business Legislative Council, and I am also here on behalf of the White House Conference for Small Business; I was a delegate at that conference. I'm a practicing tax attorney. I specialize in qualified retirement plans and estate planning, and I've been doing it, I guess, fortunately or unfortunately, for 20 years.

The SBCA represents the interests of privately held and family owned businesses in the tax, health care, and employee benefits area. We're the technical tax group for small business. The Small Business Legislative Council is a permanent, independent coalition of nearly 100 trade and professional associations that share a common commitment to the future of small business. The SBLC represents interests in such diverse areas as manufacturing, retailing, distribution, professional technical services, construction, transportation, and agriculture.

At the White House Conference on Small Business, the 1995 White House Conference, the Pension Simplification and Revitalization Recommendation received the 7th highest ranking in terms of votes of all of the recommendations. There were 60 that ultimately went to Congress and the President, and the pension recommendation was number 7. Interestingly enough, many of the recommendations that were contained in that number 7 recommendation are included in H.R. 3788 which was the bill that was just introduced yesterday by Congressman Portman and Congressman Cardin.

To truly appreciate the magnitude of this bill, I think it's important to look back a decade and see where we were. If you will, I want to spend a few seconds reading an excerpt from testimony that I gave in front of the Senate Finance Committee in 1990 also on behalf of SBCA and SBLC, and here I'm reading from this testimony I did eight years ago: "The voluntary, private retirement system is being slowly destroyed by a relentless layering of complex tax laws. Over the last decade, Congress has amended and revised the tax laws governing retirement plans at an alarming rate in the quest to find short-term revenue to offset the budget deficit. The long-term impact of the bill on the retirement system is not given enough consideration. This piecemeal legislation is taking its toll on the retirement system in America.

In the last seven years alone, there have been eight major laws having a significant impact on retirement plans—and then the statement goes on to list them. Statistics are now available to show that retirement plan terminations are increasing rapidly while new plan adoptions are slowing down dramatically. The decline for new defined plans is precipitous; a drop greater than 80 percent. Ten years ago—now, remember, this is 18 years ago—when the voluntary retirement system was stable and the rules were clear, the

system was flourishing. Cost to administrators and pension specialists were reasonable, and companies were able to take actions knowing what the results would be. The system was working extremely well.

Congress has a real opportunity to return the system to its prior simplicity, reliability, and clarity while retaining the reforms that have been rejected into the system during the last several years. The second step in restoring system to its prior viability would be to restore retirement benefits to the levels they were at prior to the onslaught of this legislation." The statement then listed approximately 15 areas which would help to resuscitate this system. Eight years later, many of these suggestions are contained in the pension simplification legislation we're addressing today.

All members of this committee, and, indeed, of Congress should be proud of this legislation. It accomplishes that very rare thing which is to remove layers and layers of overly complex and unnecessary rules. I believe that this one law combined with the two excellent laws that were just passed the last two years will give true life to the retirement plan system.

The hours and attention put in by Congressman Portman, Congressman Cardin, and Congresswoman Johnson have to be mentioned. This is a superbly crafted pension bill, and it reflects an enormous commitment to understanding this highly technical area. I read this bill—I think out of 100 pages or something, I found one thing that I thought might need a technical correction. So the amount of technical skill that was brought to this bill is just outstanding. There are so many areas that the Small Business Council of America and SBLC agrees with in this bill, that it would take me another five minutes to list everything. And we truly believe that by restoring the limits back to where they were 18 years ago, this will accomplish more than any other bill, plus the changes in the 401(k) area are superb. Thank you.

[The prepared statement follows:]

Small Business Council of America

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TESTIMONY OF

THE SMALL BUSINESS COUNCIL OF AMERICA (SBCA)

AND

THE SMALL BUSINESS LEGISLATIVE COUNCIL (SBLC)

BEFORE THE

COMMITTEE ON WAYS AND MEANS

May 5, 1998

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STATEMENT OF PAULA A. CALIMAFDE ON BEHALF OF
THE SMALL BUSINESS COUNCIL OF AMERICA
AND
THE SMALL BUSINESS LEGISLATIVE COUNCIL

BEFORE THE COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

PENSION SIMPLIFICATION

May 5, 1998

The Small Business Council of America (SBCA) is a national nonprofit organization which represents the interests of privately-held and family-owned businesses on federal tax, health care and employee benefit matters. The SBCA, through its members, represents well over 20,000 enterprises in retail, manufacturing and service industries, virtually all of which sponsor retirement plans or advise small businesses which sponsor private retirement plans. These enterprises represent or sponsor well over two hundred thousand qualified retirement plans and welfare plans, and employ over 1,500,000 employees. The Small Business Council of America is fortunate to have substantial business and legal advisory boards which have tremendous depth of technical expertise in the qualified retirement plan system for small businesses.

The Small Business Legislative Council is a permanent, independent coalition of nearly one hundred trade and professional associations that share a common commitment to the future of small business. SBLC members represent the interests of small businesses in such diverse economic sectors as manufacturing, retailing, distribution, professional and technical services, construction, transportation, tourism, and agriculture. Because SBLC is comprised of associations which represent a myriad of small business, it always presents a reasoned and fair position which benefits all small businesses.

I am Paula A. Calimafde, Chair of the Small Business Council of America and a member of the Board of the Small Business Legislative Council. I am also a practicing tax attorney (over 20 years) who specializes in the qualified retirement plans and estate planning. I can also speak on behalf of the Small Business Delegates to the 1995 White House Conference on Small Business at which I served as a Delegate. At this conference the Pension Simplification and Revitalization Recommendation received the seventh highest ranking in terms of votes. The Pension

Simplification legislation which we are discussing today incorporates almost all of the recommendations made by the delegates to the 1995 White House Conference on Small Business.

Why did the Delegates consider this recommendation to be so important as to vote it as the seventh out of the final sixty recommendations? The reason is simple - small business owners want retirement to be a viable option for them. For small business, the qualified retirement plan is the best way to save for retirement. Based in part on the current tax law, most small businesses do not provide nonqualified pension benefits, stock options and other perks. Unfortunately, small businesses perceive the qualified retirement plan area to be a quagmire of complex rules and burdens. It is perceived as a system which discriminates against key employees. The Conference Delegates understood that if the retirement system became user friendly then they would want to use it. By doing so, they could provide for their own retirement security, while at the same time providing retirement benefits for their other employees.

Our focus today is on pension simplification and on H.R. 3788 introduced by Congressman Portman and Congressman Cardin on May 4, 1998. To truly appreciate the magnitude of this bill, it is important to look back a decade. Here is an excerpt from written testimony that the SBCA and the SBLC submitted to the Senate Finance Committee on March 23, 1990:

"NEEDLESS COMPLEXITY IN THE PRIVATE RETIREMENT SYSTEM AND ITS NEGATIVE IMPACT ON PENSION COVERAGE

The voluntary private retirement system is being slowly destroyed by a relentless layering of complex tax laws. Over the last decade, Congress has amended and revised the tax laws governing retirement plans at an alarming rate. In the quest to find short term revenue to offset the budget deficit, the long term impact of a bill on the retirement system is not given enough consideration. This piecemeal legislation is taking its toll on the retirement system in America.

In the last seven years alone, the following major laws have impacted significantly on retirement plans: The Tax Equity and Fiscal Responsibility Act of 1982; The Deficit Reduction Act of 1984; The Retirement Equity Act of 1984; The Tax Reform of 1986; The Omnibus Budget Reconciliation Act of 1986; The Omnibus Budget Reconciliation Act of 1987; The Technical and Miscellaneous Revenue Act of 1988, and The Revenue Reconciliation Act of 1989. This is simply too many changes for any system to assimilate properly....

The frequency and complexity of these changes in the retirement plan area is greatly exacerbated by IRS regulations which can be any or all of the following; untimely, effective retroactively, or difficult to comprehend even by specialists. Often

needed regulatory guidance is not issued until after the plan has had to comply with the law change. In some cases, the change is so incomprehensible that IRS basically suspends operation of the law until it can figure out what to do with the change....

Statistics are now available which show that retirement plan terminations are **increasing** rapidly while new plan adoptions are slowing **down** dramatically. Data derived from Internal Revenue Service determination letter requests indicates that new retirement plan establishments have declined by at least 70% in the last 8 years. **The decline for** new **defined** benefit plans is even more precipitous - **a drop greater** than **80%**. Conversely, termination of plans **has increased markedly** - more than 100% in the last **9** years....

Ten years ago, [this is now 18 years ago!] when the voluntary retirement system was stable and the rules were clear, the system was flourishing. Costs to administrators and pension specialists were reasonable and companies were able to take actions knowing what the results would be. The system was working extremely well. Instead of throwing out the baby with the bath water, Congress,... has a real opportunity to return the system to its prior simplicity, reliability and clarity while retaining the reforms that have been injected into the system during the last several years. The second step in restoring the system to its prior viability would be to restore retirement benefits to the level they were at prior to the onslaught of legislation."

The statement then lists approximately 15 areas where simplification or revisions are essential for small businesses to be able to sponsor retirement plans. *MANY OF THESE SUGGESTIONS OR CHANGES TO RESUSCITATE THE RETIREMENT SYSTEM IS ADDRESSED BY THIS PENSION SIMPLIFICATION LEGISLATION.*

ALL MEMBERS OF THIS COMMITTEE AND INDEED OF CONGRESS SHOULD BE PROUD OF THIS LEGISLATION. IT ACCOMPLISHES THAT MOST RARE OF ALL ACTIONS - A TRUE SIMPLIFICATION OF THE SYSTEM BY REMOVING LAYER UPON LAYER OF OVERLY COMPLEX AND UNNECESSARY RULES. THIS COMMITTEE UNDERSTANDS THAT THE SYSTEM IS NOW ABLE TO BREATHE WHILE NOT DESTROYING ITS UNDERLYING STRUCTURE. THE FAIRNESS OF THE SYSTEM FOR ALL EMPLOYEES - BOTH NON-HIGHLY COMPENSATED AND HIGHLY COMPENSATED IS RETAINED. The hours and attention put in by Congressman Portman, Congressman Cardin and Congresswoman Johnson must be me mentioned. This is a superbly crafted bill which reflects an enormous commitment to understanding a highly technical and specialized area. The SBCA and the SBLC believe that this bill will bring back the retirement system for small businesses.

The graying of America, and the burden that it will place on future generations, should not be ignored. The American Council of Life Insurance reports that from 1990 to 2025, the percentage of Americans over 65 years of age will increase by

49%. This jump in our elderly population signals potentially critical problems for Social Security, Medicare and our nation's programs designed to serve the aged.

While we must assure our citizens that Social Security and Medicare will remain strong and stable, the private retirement system and private sources for retiree health care will have to play a more significant role for tomorrow's retirees. The savings that will accumulate for meeting this need will contribute to the pool of capital for investments that will provide the economic growth needed to finance the growing burdens of Social Security and Medicare. *THE POLICY DIRECTION REFLECTED BY THIS LEGISLATION WILL ENSURE THAT THE SUCH SAVINGS WILL FLOW INTO THE RETIREMENT PLAN SYSTEM AND WILL BE SUFFICIENT TO PROVIDE A SECURE RETIREMENT FOR AS MANY AMERICANS AS POSSIBLE.*

The last two bills passed by this Congress, dealing with the retirement plan system, began the process of simplifying the technical compliance burdens so that small businesses are able to sponsor qualified retirement plans. This bill is another huge step forward. Indeed, if this legislation becomes the law, only a few changes remain to fully restore the system to its former health prior to the onslaught of negative and complex changes of the 1980's.

The SBCA and the SBLC strongly support the following items in this Pension Simplification legislation which will greatly assist small businesses in sponsoring retirement plans:

401(k) Changes

The 401(k) Plan is a tremendous success story. The excitement generated by this plan is amazing. Prospective employees ask potential employers if they have a 401(k) plan and if so, what the investment options are and how much does the employer contribute. Employees meet with investment advisors to be guided as to which investments to select, employees have 800 numbers to call to see how their investments are doing and to determine whether they want to switch. Employees discuss among themselves which investment vehicles they like and how much they are putting into the plan and how large their account balances have grown.

The forced savings feature of the 401(k) plan cannot be underestimated and must be safeguarded. When a person participates in a 401(k) plan, he or she cannot remove the money on a whim. Savings can be removed by written plan loan which cannot exceed 50% of the account balance or $50,000 whichever is less. Savings can be removed by a hardship distribution, but this is a tough standard to meet. The distribution must be used to assist with a statutorily defined hardship such as keeping a house or dealing with a medical emergency. This must be contrasted to funds inside an IRA or a SIMPLE (which in reality is nothing more than an employer sponsored IRA program) where the funds can be accessed at any time for any reason.

True, funds removed will be subject to a 10% penalty (which is also the case for a hardship distribution from a 401(k) plan), but preliminary and totally unofficial data suggests that individuals freely access IRAs and SEPs (also nothing more than a glorified IRA) and that the 10% penalty does not seem to represent a significant barrier. In fact, this is why the SIMPLE IRA starts off with a 25% penalty for the first two years an individual participates in SIMPLE in hopes that if a participant can accumulate a little bit he or she will be tempted to leave it alone and watch it grow. Nevertheless, there is a distinct difference between asking the employer for a loan or a hardship distribution and having to jump through some statutorily and well placed hoops versus simply removing money at whim from your own IRA.

We have made no mention of the SIMPLE 401(k) plan because statutorily it is not as beneficial as the SIMPLE IRA so there is little reason for any company to adopt it. Further, the 401(k) safe harbors will be where all the action is with small business 401(k) plans in any event.

* **Increasing 401(k) contributions from $10,000 to $15,000 is a significant, beneficial change which will assist many employees, particularly those who are getting closer to retirement age.**

* **Opening up the second 401(k) Safe Harbor, the "Match Safe Harbor" to small businesses by exempting it from the Top-Heavy Rules is a valuable change which places small businesses on a level playing field with larger entities.** We believe that the voluntary safe harbors will prove to be the easiest and most cost effective way to make the 401(k) plan user friendly for small businesses. If a small business makes a 3% contribution for all non-highly compensated employees, or makes the required matching contributions, then the company no longer has to pay for the complex 401(k) antidiscrimination testing (nor does it have to keep the records necessary in order to do the testing). We recognize that many companies will choose to stay outside the safe harbor because the 3% employer contribution or required match "cost of admission" is too high and because it is more cost-effective to stay with their current system (including software and written communication material to employees). *However, we strongly believe that small business will embrace the voluntary safe harbors that do away with costly complex testing. This legislation which allows small businesses to use either safe harbor could very well prove to be enough of an incentive for companies to begin sponsoring a 401(k) retirement plan.*

* **Excluding 401(k) contributions made by the employees from the IRC Section 404 15% deduction limit will make these plans better for all employees.** Today, employee 401(k) contributions are included in the Section 404 limit. Section 404 limits a company's deduction for profit sharing contributions to 15% of eligible participants' compensation. This limit covers both employer and employee 401(k) contributions. This limitation now operates against public policy; either employer contributions are cut back which works to the detriment of the employees' retirement

security or employee pre-tax salary deferred contributions must be returned to the employee. Thus, employees lose an opportunity to save for their retirement in a tax-free environment. This is particularly inappropriate since the employee has taken the initiative to save for his or her retirement, exactly the behavior Congress wants to encourage, not discourage.

* **Repeal of the complicated "Multiple Use Test" is a very welcome change and will benefit the entire retirement plan system.** This test was nearly incomprehensible and forced small businesses (really their accountants or plan administrators) to apply different anti-discrimination tests to employer matching contributions than what may have been used for the regular 401(k) anti-discrimination tests.

* **Allowing employee-pay all 401(k) plans for small business is fair.** Prior to this legislation, if a key employee made a contribution to the 401(k) plan sponsored by a small business more often than not the top-heavy rules were triggered which required the small business to make a 3% contribution for all non-key employees. Not only was this a trap for the unwary since many small businesses, including their advisors, were unaware of this strange rule, but it was also unfair since a larger company would be able to sponsor an employee-pay-all 401(k) plan and not have to make any employer contributions to the plan. The practical effect of this rule was that small businesses which wanted to sponsor employee-pay-all plans would not allow the key employees to contribute to the plan - reverse discrimination and so often not used. This is a welcome and fair change for small business. The regular 401(k) anti-discrimination tests are more than sufficient to ensure that the non-highly compensated employees are treated fairly vis a vis the highly compensated employees.

* **The so-called "Catch-Up Contributions" for people approaching retirement will not be very helpful for small business employees because these catch-up contributions are subject to all of the 401(k) anti-discrimination testing.** We believe most small businesses will probably try to avoid all of this testing by complying with the 401(k) safe harbors, so that it is unlikely that this catch up will even be available to small business employees. The only way to make this workable for small business would be to exempt it from the anti-discrimination testing. In any event, increasing the 401(k) dollar limit to $15,000 and eliminating the 25% of compensation limitation would appear to be far more important to small business employees.

Changes to Plan Contribution Limits

Perhaps the most important change in this legislation is increasing the dollar limits on retirement plan contributions, removing the 25% of compensation limitation and increasing the compensation limitation.

Here's a real life example from my law firm's 401(k) profit sharing plan which illustrates the negative impact of the 25% limitation on employees:

Sandy is a paralegal who makes an annual salary of $41,500 and has worked for the firm for 17 years. Prior to the firm's fiscal year end (April 30), the plan called for a 3% profit sharing contribution for employees plus employees were allowed to defer a portion of their salary into the 401(k) plan. Sandy deferred $8,200 of her salary as a 401(k) contribution into the plan. The plan's profit sharing formula was just changed for this year so that employees with less than 10 years of service will receive a 3% contribution, employees with 10 years of service but less than 15 years of service will receive a 3.5% contribution, employees with more than 15 years but less than 20 will receive a 4% contribution and employees with 20 years or more will receive a 4.5% contribution. This means that Sandy will receive a profit sharing contribution of $1,660 (4% x $41,500). Unfortunately, the 25% of compensation limitation is applied by reducing Sandy's compensation by the amount of the 401(k) contribution she made - $41,500 - $8200 = $33,300 x 25% = $8,325. When the employer profit sharing contribution ($1,660) is added to the 401(k) contribution ($8,200), it equals $9,860 which is higher than the amount allowed by the 25% limitation which is $8325. Because of the 25% limitation, the firm is required to return to Sandy $1,535 of her own 401(k) contributions. This is a shame since we should be doing everything to encourage savings - not discourage them! The only two people in our firm which has 60 plan participants who ran into the 25% problem were Sandy and another employee who is a secretary. It is interesting to note that Sandy's account balance in the profit sharing 401(k) plan is $84,000 and the other employee who was cut back has an account balance of $41,000 and the plan has only been operating for 8 years. Repealing the 25% limitation would allow employees like Sandy to keep her 401(k) savings in the plan and would also reduce administrative complexity for the sponsoring companies.

* **Increasing the $150,000 compensation limit to $235,000 is an important change which will bring the plan contributions back into line with 1998 dollars.** The $150,000 limit in 1974 (ERISA) dollars is about $46,500 (assuming 5 percent average inflation). This is far below the $75,000 that represented the highest amount upon which a pension could be paid under then-new Code Section 415 (back in 1974). This cutback has hurt several groups of employees - owners and other key employees of all size businesses who make more than $150,000 and mid-range employees and managers (people in the $50,000 to $70,000 range) who are in 401(k) plans and in defined benefit plans. This cutback was perceived by owners and other key employees of small businesses as reverse discrimination and as a disincentive in establishing a retirement plan.

* **Increasing the defined contribution limit from $30,000 to $45,000 and the defined benefit limit from $130,000 to $140,000 are strong changes which will increase retirement security for many Americans.** These numbers are in line with

actual inflation. In fact, if you assume an average 2% COLA with compounding so we increase the $30,000 form 1984 to the present at an average of 3% over 14 years, the defined contribution limit would be $45,379 and the defined benefit limit would be $151,250. This assumed inflation rate is probably a good deal lower than the actual COLA during those 14 years.

Top Heavy Rules

These rules are now largely duplicative of many other qualification requirements which have become law subsequent to the passage of the top-heavy rules. They often operate as a "trap for the unwary" particularly for mid-size businesses which never check for top-heavy status and for micro small businesses which often do not have sophisticated pension advisors to help them. These rules have always been an unfair burden singling out only small to mid-size businesses. ***The changes made in this legislation will significantly simplify the retirement system with little to no detriment to any policy adopted by Congress during the last decade.*** The top-heavy rules have required extensive record keeping by small businesses on an ongoing 5 year basis. They also have represented a significant hassle factor for small business - constant interpretative questions are raised on a number of top-heavy issues and additional work is required to be done by a pension administrator when dealing with a top-heavy plan, particularly a top-heavy 401(k) plan.

SBCA and SBLC support the repeal of the family attribution for key employees in a top-heavy plan, as well as finally doing away with family aggregation for highly compensated employees. These rules require a husband and wife and children under the age of 19 who work in a family or small business together to be treated as one person for certain plan purposes. They discriminate unfairly against spouses and children employed in the same family or small business.

We also support the simplified definition of a key employee as well as only requiring the company to keep data for running top heavy tests for the current year rather than having to keep it for the past four years in addition to the current year. We also applaud the very important changes mentioned above in the 401(k) area.

SIMPLE Plans

We believe that the SIMPLE plan should be viewed only as a starter plan and that all businesses, including the very small, should be given incentives to enter the qualified retirement plan system as quickly as possible. The SIMPLE is an IRA program, as is the old SEP plan and in the long run true retirement security for employees is better served by strengthening qualified retirement plans rather than SIMPLES and SEPs. This is simply because employees have a far greater opportunity to remove the money from IRAs and SEPs and spend it - the forced savings feature of a qualified retirement plan is not present. While we appreciate that for start-up

companies or micro businesses, a SIMPLE or the proposed salary reduction SIMPLE may be a good first step into the retirement plan system, the company should be encouraged to enter the qualified retirement system as soon as possible. By making the SIMPLE rules "better" than the qualified retirement system, the reverse is achieved and a bonus plan is not what the country needs to ensure that its long term retirement needs are met. Thus, we hope that the "gap" between the 401(k) limit ($15,000) and the SIMPLE limit ($10,000) and the salary reduction SIMPLE limit ($5,000) is carefully preserved so that the system does not tilt in the wrong direction.

Required Minimum Distribution Rules

We strongly support moving back the required beginning date for receiving retirement plan benefits from 70 1/2 to 75. We would encourage the Committee to consider whether the rule which delays receiving distributions for all employees other than 5% owner until actual retirement, if later, should be extended to 5% owners. There seems to be no policy rationale for forcing 5% owners to receive retirement distributions while they are still working. **We believe the $300,000 exemption is a worthwhile change in the law which will greatly increase simplification.**

We also respectfully suggest the following:

1. **Allow direct lineal descendants of the participant, in addition to a spouse, to have a roll-over IRA.** Today, if a participant dies and names the spouse as beneficiary, the spouse can "roll-over" the retirement plan assets into an IRA, rather than receiving payments from the retirement plan. On the other hand, if a participant dies and names his or her children as the beneficiaries, the children cannot roll-over the assets into an IRA and will in most cases be forced to take the distribution in one lump sum. This triggers the problem set forth in 2 below.

2. **Provide an exemption of retirement plan benefits from estate taxes.** As mentioned above, if the children are forced to take a lump sum distribution (and assuming they have no surviving parent), the entire retirement plan contribution is brought into the estate of their parent who was a plan participant and is subject to immediate income tax. This is the fact pattern where the plan distribution is reduced by up to 85% due to taxes - federal and state income taxes and federal estate taxes. This is why people often say they don't want to save in a retirement plan because if they die the government takes it all and the children and grandchildren receive way too little.

Plan Loans for Sub-S Owners, Partners and Sole Proprietors

This is a long overdue change to place all small business entities on a level playing field. We support this change.

Repeal of 150% of Current Liability Funding Limit

This is a very technical issue, but basically defined benefit plans are not allowed to fund in a level fashion. Code Section 412(c)(7) was amended to prohibit funding of a defined benefit plan above 150 percent of current "termination liability." This is misleading because termination liability is often less that the actual liability required to close out a plan at termination, and the limit is applied to ongoing plans which are not terminating. In effect, current law inappropriately mortgages benefit promises by prohibiting the level funding that is the reasonable way for plans to fulfill benefit obligations and, instead, requires plans to be funded with payments which escalate in later years. *This provision is particularly detrimental to small businesses who simply cannot adopt a plan which does not allow funding to be made in a level fashion.*

We believe this limitation should ultimately be repealed, but we appreciate all of the efforts in this bill to assist small businesses in adopting defined benefit plans and giving small businesses the ability to fund the benefits in a more level fashion. We also applaud the change in the variable rate premium which will assist small businesses which are not allowed to fund in a proper fashion because of this limitation.

This legislation will dramatically improve the existing retirement plan system. By making the system more user friendly, more small businesses will sponsor retirement plans. Easing administrative burdens will reduce the costs of maintaining retirement plans. The changes would revitalize the retirement plan system for small business. Finally, most of the substantive changes made by Congress in the 1980's would be retained and the time tested ERISA system would stay in place. Ultimately, it is essential for this country to do everything possible to encourage retirement plan savings so that individuals are not dependent upon the government for their retirement well-being.

Chairman JOHNSON of Connecticut. Thank you very much.
Mr. English.

STATEMENT OF GLENN ENGLISH, CHIEF EXECUTIVE OFFICER, NATIONAL RURAL COOPERATIVE ASSOCIATION

Mr. GLENN ENGLISH. Thank you very much, Madam Chair. I appreciate the opportunity to appear before you today. My name is Glenn English. I'm the Chief Executive Officer of the National Rural Electric Cooperative Association. We have 1,000 not for profit consumer owned electric systems in 46 States throughout this Nation. The National Rural Electric Cooperative Association administers the pension and welfare benefits for over 130,000 employees and their dependents, as well as directors throughout the various States.

Madam Chair, we feel that there is a continuing need for strengthening and simplifying the laws that affect the retirement programs across this country. We also believe in expanding coverage and in protecting the benefits and financial security of those that are in retirement. Pension legislation enacted in the last several years has gone a long way to accomplish those objectives.

But I think this hearing today, Madam Chair, is desperately needed and I want to commend you for focusing attention on this very great need that all Americans have in their retirement. I appreciate the interest that's being shown by the members of this committee on this subject. So you all are to be commended for that.

Madam Chair, we strongly support the Retirement Security for the 21st Century Act that is being offered by Representative Portman and Cardin. Both representatives, I think, are to be praised for offering this legislation. I too would, being a former member of Congress, recognize that all such legislation needs great staff work to make sure it accomplishes the results of the vision of the various members involved, and so I want to commend Barbara Pate and David Cosgarian for their work on this legislation.

I'd like to focus on three areas that we find of particular interest. One is in the area of expanding coverage. We applaud the increase in the limits on contributions and benefits for both the defined benefit and defined contributions plan. We also applaud the repeal of section 415 rule, limiting contributions to 25 percent of the pay, and feel that that would go far in stimulating savings in this Nation.

Also, the expanding the portability is something that is of great interest to NRECA. Today, NRECA provide for portability among those employees of Rural Electric Cooperatives as they move from electric cooperative to electric cooperative. This opportunity should be extended to all Americans. All Americans should have the ability to expand their savings by rolling over their contributions. This reflects the increasing mobility of the American workforce.

We are particularly interested in the proposed changes affecting rollovers from section 457, plans and deferred compensation plans into other qualified plans or IRA's. Let me also, Madam Chair, focus attention on reducing the regulatory burdens. This is something that I know that all of us are particularly concerned about. The rules and regulations governing the qualified retirement plans

are extremely complex and I know that this committee has heard that over and over again—the need for some assistance.

I know that this committee is focusing attention on how to simplify the rules and regulations. Over the years, the Internal Revenue Service has developed programs to address many of the problems in this enforcement area. Recently the IRS has issued a revenue procedure expanding the various compliance resolution programs that are already in place. I think the Service these days—they're receiving their fair share of criticism—but their work in this area should be commended and receive significant credit for responding to employers' concerns. The revenue procedure, 98–22, will do much to advance the plans' compliance, especially among some of the smaller plans such as we have.

However, the service does not address two very important issues and I'm very pleased that the legislation that has been introduced by Representatives Portman and Cardin does exactly that. That is, if an employer corrects a violation before an audit takes place, they should not have to pay any penalty. And if an inadvertent violation is discovered in an audit, the penalty should be reasonable.

In conclusion, Madam Chair, I simply want to say that Representatives Portman and Cardin have an outstanding piece of legislation and certainly all 1,000 electric cooperatives all across this country strongly support that legislation and thank them for introducing this worthwhile bill. Thank you.

[The prepared statement follows:]

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Testimony of

Glenn English
Chief Executive Officer
National Rural Electric Cooperative Association

Submitted to the
United States House of Representatives

Committee on Ways and Means
Subcommittee on Oversight
Washington, D.C.

May 5, 1998

Madame Chairman and members of the Committee. I am Glenn English, Chief Executive Officer of the National Rural Electric Cooperative Association, which represents the nation's network of 1,000 not-for-profit, consumer-owned rural electric systems. Various programs administered by NRECA provide pension and welfare benefits to over 130,000 rural electric employees, dependents, directors and consumer members in 46 different states.

We at NRECA believe that there is a continuing need for simplification and strengthening of the laws affecting qualified retirement plans, in order to expand coverage, protect benefits and provide financial security in retirement. Pension legislation enacted during the last two years was a great first step toward achieving these goals. The bipartisan bill that is the subject of this hearing demonstrates the deep understanding of the need to do more for retirement plans, their sponsors and their participants.

I appreciate the opportunity to appear before the Oversight Subcommittee in support of the "Retirement Security for the Twenty-First Century Act", introduced by Representatives Portman and Cardin. While the vision and leadership for moving this bill forward certainly rests with both Congressmen, I would like to acknowledge the superb work done by Barbara Pate and Dave Koshgarian in drafting this bill.

Because of the comprehensive nature of the bill I won't be able to comment on all aspects of the legislation, therefore I will limit my statement here to several of the provisions that would have the greatest impact on NRECA's own plans.

Expanding Coverage

We applaud the increases in the limits on contributions and benefits for both defined benefit and defined contribution plans. These increases would stimulate new plan formation as well as significant plan improvements. Similarly the repeal of the section 415 rule limiting contributions to 25% of pay would stimulate savings. Currently, this rule artificially restrains savings by most employees without any policy justification. We believe that these changes will stimulate strong interest in retirement savings among rural electric cooperatives.

Expanding Portability

NRECA has taken a special interest in portability issues particularly because our plans offer benefit portability among the various cooperatives and other employers in the plans. This is exactly what we need to increase savings and ensure a secure retirement for employees. Having spent so much time refining the portability features in NRECA's own plans, we are extremely gratified that this legislation begins to address this very serious issue. The increasing mobility of the American workforce makes it necessary to expand the

current rules governing rollovers to allow plan participants to put all their retirement savings into one plan when they change jobs. We are particularly interested in the proposed changes affecting rollovers from section 457 deferred compensation plans into other qualified plans or IRAs. This change would allow complete portability with all our pension plans, making it easier for workers to consolidate their retirement savings. Further, allowing such rollovers increases the likelihood that pension savings will remain part of an employee's retirement plan until needed at retirement.

Reducing Regulatory Burdens

The rules and regulations governing qualified retirement plans are extremely complex. An inadvertent failure to comply with any one of the qualification requirements could result in plan disqualification. The consequences of disqualification can be catastrophic for a business sponsoring a plan as well as for its employees. Over the years the IRS has developed programs to address many of the problems in this enforcement system. Most recently IRS issued a revenue procedure expanding the various compliance resolution programs already in place. The Service deserves significant credit and thanks for their efforts in responding to employers' concerns in this area. Revenue Procedure 98-22 will do much to advance plan compliance, especially among smaller plans. However, the Service has not addressed two important issues, and I am pleased that this bipartisan legislation does address them. This bill ensures that if an employer corrects a violation before audit the employer should not be required to pay any penalty or make any submission to the IRS. The bill would also ensure that if an inadvertent violation is discovered on audit the penalty would be reasonable.

Finally, I want to address an issue of significant concern to a number of businesses, particularly regulated industries such as the electric utility industry. The issue is the timing of defined benefit plan valuations. Presently, the valuation date of a defined benefit plan for a plan year must generally be in the same year. This valuation is necessary in order to determine the amount of contributions to the plan. Because valuations can be quite time-consuming, this means that the amount of contributions for a year is often not known until well into the year. This obviously prevents accurate advance budgeting for pension contributions. This difficulty in budgeting is disruptive for businesses and can lead to unsound pension funding. The Portman Cardin bill would would simply allow well-funded defined benefit plans to use a valuation date up to one year prior to the beginning of the plan year. This allows advance budgeting and promotes sound funding without any loss of pension security. We applaud the inclusion of this provision and look forward to its enactment.

Conclusion

This bill simplifies and strengthens the pension system in meaningful ways that encourage savings, protect benefits and expand coverage.

In conclusion, we wholeheartedly support the Portman Cardin bill. More generally there are 1,000 rural electric systems that enthusiastically support the pension simplification efforts of the members of the Ways and Means Committee.

Chairman JOHNSON of Connecticut. Thank you very much, Glenn.

Mr. Walker.

STATEMENT OF THOMAS C. WALKER, PRESIDENT, ASSOCIATED BENEFITS CORPORATION

Mr. WALKER. Madam Chairwoman, Congressmen and women, and members of the staff, I thank you for the efforts you're making to deal with legislative and regulatory problems that restrict qualified plan installation and continuation for those employers who employ over half our working population, that is the small employer.

I'm president of a firm that provides prototype pension plans covering more than 18,000 employees and more than 80 percent of them are in employers with less than 100 employees.

Congresswoman Johnson was exactly on point when, in announcing this hearing, she said, and I quote, "Overly complex tax rules may be stifling the growth of healthy pension plans." A point that has always concerned me is the very restrictive rules that are in place to be sure the highly compensated do not benefit disproportionately. The concept is good and certainly politically correct, but it has negative results for the non-highly compensated that were not contemplated, nor do I believe, intended. Realistically, the highly compensated make the decision to have or not have a qualified pension plan. When the highly compensated benefit and/or contribution is compressed by law to the point where they receive much less as a percent of compensation than the non-highly compensated, then decisions are made that leave the non-highly compensated without any plan at all or a plan less generous than would have been created had the highly compensated been able to enjoy proportionate benefits.

That said, we're impressed with the stated focus of this hearing. The restoration of maximum contribution and allowable compensation limits to previous ceilings, prior to when revenue was needed, is going to create a great deal of new interest in retirement plan establishment by small employers.

The repeal of the current liability funding limit would correct a revenue raiser added in 1987 that has led to systematic plan under funding, as well as erratic, unstable, and unpredictable contribution patterns, all of which has resulted in benefit reductions and some plan terminations. One termination in particular comes to mind. The employer had a defined benefit plan and as with many small employers, employee turnover seems to be cyclical with none 1 year and up to 50 percent the next. This mean the average age and average length of service fluctuates dramatically, driving the allowable maximum contribution from nothing to as much as 6.5 percent of pay. This fluctuation is not manageable for a small business. Had the 150 percent limit not been in place, his years of 0 contribution could have had a contribution of say 3 percent, and that would have drawn down the maximum year to something in the 4 percent range. This would have been acceptable to the owner and the plan would have survived.

My written testimony also includes other legislative issues, but I want to be sure relief from regulatory burdens are verbally expressed. The only current statutory sanction for even a minor viola-

tion of any of the myriad and occasionally conflicting pension rules is complete disqualification of the plan.

The IRS deserves much credit for establishing and improving its compliance programs, including APRSC, VCR, and CAP. However, three key issues for small employers need legislative direction.

First, if an employer corrects a violation prior to audit, the employer should not be required to pay any penalty nor make any submission to the IRS. Second, if a good faith inadvertent violation is discovered upon audit, the penalty should be reasonable. And finally, and perhaps most important, innocent rank and file employees should be protected from tax sanctions.

We've seen a parade of really good pension simplification bills, but all the resulting regulations have so cluttered the pension landscape that much of what plan administrators do is make work noise that has no redeeming quality. The anti-discrimination legislative language in the Tax Reform Act of 1986 was two sentences long and is a very simple concept. You can't favor owners or highly compensated individuals in a qualified plan or you no longer have a qualified plan. The very first issue of the regulations for these 2 sentences were 687 single spaced pages, and they've expanded annually since, and now number over 1,100. And this is only one example.

Regulations designed to cover every conceivable action that any evil or demented mind could take puts a burden on the system that's unreasonable if any kind of cost benefit study were ever to be done. If every plan in this country has to spend on average $100 to comply with a regulation that stops 1 person from taking some absurd action, there are those who would say that's okay. I say that's unreasonable, and so do many small employers who have terminated plans or never installed one, because of compliance costs that do not provide one nickels worth of benefit to any person anywhere, except perhaps to the person who gets hired to keep the plan in compliance.

In summary, your willingness to hold this hearing is being applauded by many small businesses all across the land. We hope that many of the changes discussed here today become law and that the regulators find ways to regulate reasonably. While we all understand the need to temper pension laws so that the rank and file employee truly benefits, we must move away from the idea that the way to accomplish that is to be sure the fat cat doesn't benefit. That idea has prevented more rank and file employees from getting any pension at all than it has ever increased benefits for. The fat cat makes the decision.

Thank you, Madam Chairwoman, for exerting the effort necessary on your part and the part of all your staff. And thank you also to those representatives who participated today for holding this hearing. Your willingness to review the provisions of current law and regulation discussed here today is indeed encouraging to us out in the fly over zone, called Iowa. We support changing the rules to move to more facts and circumstances, common sense, let's get everybody covered simplicity. This hearing is a giant step in that direction. Thank you.

[The prepared statement follows:]

STATEMENT OF THOMAS C. WALKER
TO THE SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
HEARING ON OVERSIGHT
OF
PENSION ISSUES

ACRONYMS

ABC -	Associated Benefits Corporation
ACP -	Average Contribution Percentage
ADP -	Average Deferral Percentage
APRSC -	Administrative Policy Regarding Self Correction
CAP -	Closing Agreement Program
DOL -	Department of Labor
ERISA -	Employee Retirement Income Security Act of 1974 - as Amended
GATT -	General Agreement on Tariffs and Trade
IRC -	Internal Revenue Code
IRS -	Internal Revenue Service
PBGC -	Pension Benefit Guarantee Corporation
PWBA -	Pension and Welfare Benefits Administration
SBJPA -	Small Business Job Protection Act of 1996
S-Corp -	Corporation Taxed as Partnership
TRA97 -	Tax Reform Act of 1997
VCR -	Voluntary Compliance Resolution Program

Summary of the principal points in the statement of Thomas C. Walker in connection with the hearing of the Subcommittee on Oversight of the Committee on Ways and Means on Oversight of Pension issues.

1. Restrictive rules on highly compensated have negative affect on non-highly compensated.

2. Restore prior limitations on dollar caps for contributions and compensation.

3. Remove loan prohibited transaction rules on unincorporated businesses and Sub S Corporations.

4. Eliminate complex top heavy testing rules.

5. Make the "anti-cutback" rules for eligible rollovers workable.

6. Change same desk rule language from "separation from service" to severance from employment".

7. Repeal defined benefit plan funding limits.

8. Codify pre-audit violation corrections to no penalty and impose reasonable penalties for inadvertent violations discovered upon audit.

9. Eliminate multiple use tests since ADP and ACP testing make it unjustified.

10. Replace mechanical nondiscrimination testing with facts and circumstances rules.

11. Allow additional contributions, outside all rules and testing, for older workers.

12. Impose restrictions on the burden regulators (IRS, DOL, PBGC, PWBA) place on plans as they attempt to cover every conceivable evil.

As an introduction, I am the President of ABC, an Iowa Not-For-Profit Corporation. We are the Sponsoring Employer for over 300 employee benefit plans using prototype pension plans and welfare benefit trusts under Section 501(a) of the IRC. In addition, we are the administrator for 53 additional plans that are sponsored by other groups. We serve 220 agriculture cooperatives who provide over 18,000 of their employees with pension and welfare benefits. Our employers range in size from 1 employee to over 1500 employees and the plan assets for all the plans we serve exceeds 500 million dollars.

I was invited today because we work primarily with small employers having less than 100 employees. Chairwoman Johnson's comments, when announcing this hearing, were exactly on point with the small employer community. She said "overly complex tax rules may be stifling the growth of healthy pension plans".

A point that has always concerned me is the very restrictive rules that are in place to be sure the highly compensated do not benefit disproportionately. The concept is good, and certainly politically correct, but it has negative results for the non-highly compensated that were not contemplated nor intended.

Realistically, the highly compensated make the decision to have or not have a qualified pension plan. Please remember that the highly compensated have options for themselves that the non-highly compensated do not have. When the highly compensated benefit and/or contribution is compressed by law to the point where the highly compensated receives much less, as a percent of compensation, than the non-highly compensated, then those other options begin to have more appeal and decisions are made that leave the non-highly compensated with out any plan at all, or a plan less generous than would have been created had the highly compensated been able to enjoy proportionate benefits.

That said, we are impressed with the stated focus of this hearing. The restoration of maximum contribution and allowable compensation limits that existed in the past would be a very significant improvement and would serve as an incentive for the highly compensated to create new plans. The expansion of the 415(c) limit to $45,000 in defined contribution plans and the elimination of the 25% cap, and the increase of the 410(a)(17) limit on allowable compensation to $235,000, both amounts having been previous ceilings before revenue was needed for other things, would stimulate new interest in retirement plan establishment by small employers.

The change in 403(b) prohibitive transaction rules to participant loans for all employees, including owners of small businesses that are unincorporated or operate as S Corporations, is another improvement that would be very attractive to small employers.

A very onerous provision of the current law is Section 416, which establishes very complex testing rules to determine whether a plan is Top-heavy, in other words, do the key employees receive an excessive proportion of the benefit. This is a real killer of plans for small employers, who are the only employers that would reasonably be expected to be impacted, and are the employers where plan expansion is most needed. It was obvious that Congress wanted expansion when you passed the safe harbor 401(k) plan portion of the SBJPA of 1996. However, the interaction of the current top-heavy rules with the new safe harbor 401(k) rules effectively precludes many small employers from establishing a safe harbor 401(k) plan..... and for many..... no safe harbor equals no plan, because of the compliance costs. Remedies here would be very helpful.

The issues discussed so far will help expand coverage with employer sponsored plans. We also need to increase portability for participants. The "eligible rollover" rules need improvement, but the rule that will do the most for portability among small businesses would be a change in Section 411(d) (6), the "anti-cutback rule". This rule currently generally provides that when a participant's benefits are transferred from one plan to another, the receiving plan must preserve all forms of distribution that were available under the prior plan. This rule precludes many small employers from allowing rollovers to their plans, since the administrative costs of tracking different requirements for different employees is not justifiable. A change here to allow the participants to waive off the restrictive rules on cutbacks on distribution options would increase portability among small employers.

Portability would also be enhanced by modifying the "same desk" rule by replacing "separation from service" language in 401(k)(2)(B) with "severance from employment".

I understand there is proposed legislation that includes provisions to help strengthen pension security. The repeal of the 150% of current liability funding limit would correct a revenue raiser added in 1987 that led to systematic plan under-funding as well as erratic, unstable and unpredictable contribution patterns, all of which has resulted in benefit reductions and some plan terminations. One termination in particular comes to mind. The employer has about 30 employees and had a defined benefit plan. As with many small employers, employee turnover seems to be cyclical, with none

one year and 50% the next (not real numbers, but illustrative). This means the average age, average length of service and lump sum distributions (for those with future value of accrued vested benefits of under $3500 (now $5000)) fluctuated dramatically, driving the allowable maximum contribution from 0 to as much as 6½% of pay. This fluctuation is not manageable for a small business. The defined benefit plan was terminated and replaced with a defined contribution plan. Had the 150% limit not been in place, his years of 0 could have included a contribution of say 3% and that would probably have drawn down the maximum year to something in the 4% range. This would have been acceptable to the owner and the plan would have survived.

We also need some very real relief of regulatory burdens. The only current statutory sanction for even a minor violation of any of the myriad (and occasionally conflicting) pension rules is complete disqualification of the plan.

The IRS deserves much credit for establishing and improving it's compliance programs, including APRSC, VCR and CAP. However, three key issues for small employers need legislative direction. First, if an employer corrects a violation prior to audit, the employer should not be required to pay any penalty or make any submission to the IRS. Second, if a good faith inadvertent violation is discovered upon audit, the penalty should be reasonable and finally, innocent rank and file employees should be protected from tax sanctions.

I understand another fantastic regulatory relief is provided in proposed legislation that would eliminate the multiple use test under 401(m)(9)(A). The multiple use test is complex, duplicative and unnecessary, as the ADP and ACP tests alone will effectively eliminate discrimination in favor of highly compensateds, and the added complicated testing mandated by the multiple use test is simply not justified.

The nondiscrimination rules under Section 401(a)(4) and the Section 410(b) coverage rules consist of a series of complicated mechanical tests. In both cases, prior to recent changes, these sections were applied based on facts and circumstances. We need to return to common sense facts and circumstances, recognizing that while mechanical rules can function as safe harbors, employers need the right to demonstrate that their plan coverage and benefits are clearly nondiscriminatory based on all the facts and circumstances.

Another area of great concern to small businesses is the position of the IRS regarding how plans should work between legislation and regulation. Plan Sponsors providing Prototype Plans to small businesses are not going to

amend those plans for GATT, SBJPA and TRA97 until 1999 because they want regulations first. The IRS has given conflicting guidance by telling us these plans can be operated in compliance with these rules if, in fact, the plan is eventually amended to reflect exactly how you operated the Plan, but not in the area of funding. For example, the IRS has advised they will not allow an employer to fund for the elimination of the family aggregation rules unless the Plan has been amended to eliminate family aggregation. The Prototype Plan Sponsor is not inclined to amend until necessary, in order to have as much regulatory input as possible. The small employer is the loser. Bad result

There is also an idea floating around that appeals greatly to me. This is the $5000 per year allowable additional contribution to my 401(k). As a 60 year old, I could only beg that you add a ten or fifteen year look-back rule to this provision.

We have seen a parade of "pension simplification" bills, both proposed and passed, over the last 10 or so years. Since ERISA in 1974, the hodgepodge of legislation, and resulting regulations, has so cluttered the pension landscape that much of what plan administrators do is make-work noise that has no redeeming quality.

The anti-discrimination legislative language in the Tax Reform Act of 1986 was two sentences long, and is a very simple concept - you can't favor owners or highly compensated individuals in a qualified plan or you no longer have a qualified plan. The very first issue of the regulations these two sentences of legislation produced were 687 single spaced pages, expanding annually since, and now numbering over 1100 pages.....and this is only one example.

Small employers are in business for themselves primarily because they want to be in control of their own destiny. When it comes to pensions, the business can be the owner's pension and if he successfully builds it up, it can be a very good one. If we make qualified plan rules understandable, with no more than a few hours needed to reach understanding, and make it possible for the small business to install a plan with only reasonable costs incurred, they will do so, because virtually every small business person I know truly does care about their employees. They tend to view their employees more like extended family, than like the human asset, with a number, that large companies use. What they won't tolerate is a system that is filled with traps that could cost them their own pension, i.e. the business, if they stumble into one.

Regulations designed to cover every conceivable action that any evil or demented mind could take puts a burden on the system that is unreasonable if any kind of cost/benefit study were done. If every plan in the country has to spend an average of $100 to comply with a regulation that stops one idiot from taking some absurd action, there are those who would say that is OK. I say that is unreasonable, and so do many small employers who have terminated plans, or never installed one because of compliance costs that do not provide one nickel's worth of benefit to any person anywhere, except perhaps the person who gets hired to keep the plan in compliance.

In summary, your willingness to hold this hearing is being applauded by small businesses all across the land. We hope that many of the changes discussed here today become law, and that the regulators find ways to regulate every two sentences of legislation with less than 687 pages of rules. While we all understand the need to temper pension laws so that the rank and file employee truly benefits, we must move away from the idea that the way to accomplish that is to be sure the fat cat doesn't benefit. That idea has prevented more rank and file employees from getting any pension than it has ever increased benefits for. The fat cat makes the decision.

Thank you Madam Chairwoman, for exerting the effort necessary on your part and the part of all your staff, and thank you also to those Representatives who participated today, for holding this hearing. Your willingness to review the provisions of current law and regulation discussed here today is indeed encouraging to those of us out in the fly-over zone called Iowa. We support changing the rules to move to more facts and circumstances, common sense, lets get everyone covered simplicity. This hearing is a giant step in that direction.

Respectfully Submitted,

Thomas C. Walker

Chairman JOHNSON of Connecticut. Thank you very much for your comments and your testimony and for your review of the Portman-Cardin legislation, which is going to bring us dramatically forward. Let me ask you a couple of different questions.

First of all, on the issue of catch up provisions—I've described this in terms of the different pattern of working life commonly—it's common for women. But last year we amended the legislation governing teachers to allow them to buy back more in their latter years of service, than the law currently allows—for exactly not the pattern of employment reason, but the pattern of affluence in our lives recently. When you're young you have children and then college, and so on and so forth. The time when you can really invest more money into retirement than any other is when you're still working, when your kids have gone off to school, you've bought your home, you've got your car.

We are—Mr. Weller mentioned some legislation that would affect the construction trades, but it's the same concern. It's the same principle. That there are times when you put more in and there are times when you put less in. And our current laws don't allow us to maximize our retirement security, because they don't allow us to put money in when we are able to recognize the money that we've put in the past when we were able in a way that is fair and reasonable.

When you look at the issue of catch up contributions, does the Portman-Cardin bill allow us to look at—does it structure catch up contributions in a way that would, in a sense, solve the problems of all of these groups, working women, people who have contributed more in the past to their pension plans than they are able to in the last three years, and so on and so forth. Would you just comment on the structure of the catch up provisions.

Mr. KLEIN. I'll take a crack at it first. It may not completely solve the problem certainly, but it makes a wonderful step in the right direction. And by the way it is drafted across the board in that way. It's flexible enough. It's particularly helpful I think to women and others who may have been out of the workforce for periods of time while they were raising children and so forth. And I couldn't say it any better than you that it reaches people at a point in time in their lives when they may have more discretionary income to set aside for their retirement needs.

Chairman JOHNSON of Connecticut. Ms. Calimafde.

Ms. CALIMAFDE. I think in the small business area, there's going to be some problems with it. And the reason why is because the catch up is subject to the discrimination test in the 401(k) area and I believe that most small businesses are going to opt to go into the safe harbors and be done with all that anti-discrimination testing. And my guess is that this will just be not available really for small business employees, because it just brings them right back into all that testing again. So, it's the problem with the testing which is going to cause the small business to say no catch ups here, because it's just going to cost too much to do it administratively. Of course, if the safe harbor included catch up contributions, then this would go a long way towards easing administrative problems.

Chairman JOHNSON of Connecticut. Let me then go on to my second question. The non-discrimination rules, the limit on annual

contributions, and the top heavy rules, all speak to the same concern—that Congress doesn't want to have taxpayers subsidize rich retirement plans for high earners without low earners having equitable benefit. Do we need all three? Which ones should we—how could we achieve our goals in a far simpler manner? Does the Portman-Cardin bill go as far in that direction as we can or is it time to simply dump the non-discrimination rules? Can we achieve that same goal through simply salary limits and percentage of salary contributable limits? Is there a simple way to do this?

Mr. Walker.

Mr. WALKER. I would like to suggest that the problem of the top heavy rules does come into play very dramatically with small employers. The Small Business Job Protection Act introduced a safe harbor for 401(k) plans that required certain contributions for the non-highly compensated in order to meet the safe harbor. Unfortunately, in many small employers where you have an older highly compensated individual and then perhaps two or three young, fairly low paid individuals, the safe harbor isn't available to them because the top heavy rules get in the way. The plan is going to become top heavy right away and it's going to therefore fail the safe harbor test.

I think we need to be realistic in looking at limits that certainly don't favor highly compensated, but I think that we have tended to not only not favor, but perhaps even punish the highly compensated through the rules that we've put in place. I understand the general feeling about why these rules are necessary. I think, however, that they are punishing the wrong people because I think what it ends up punishing is the non-highly compensated who end up without a plan at all.

Chairman JOHNSON of Connecticut. Any other comments? Mr. English.

Mr. GLENN ENGLISH. Madam Chair, if I might, there's another element I think that sometimes we oversimplify and overlook and that is this: I'm not sure income has that much to do with whether people save or not. We read stories every day about people who make enormous amounts of money that don't save. You've got other folks that make very modest means who accumulate a good deal. It basically comes down to the discipline and the habits that those individuals have.

It is my understanding that part of the overall objective is to try to encourage people to save, and we would like to do that. I think that we all agree that that is the purpose with regard to these programs. And as I understand it, with Representatives Portman and Cardin, that's the objective of what they'd like to do—is to give these people the opportunity to save more.

So I think we have to take a little bit of that into account—not oversimplify and encourage people to save. I think that when we do we will find that probably this is going to have a bigger impact on people who we would not consider to be in the upper limits of compensation in this country. It's probably going to have more of an impact on ordinary Americans than it is on those high income folks. Common sense ought to come into play here a little bit. We ought to keep in mind what it is we're trying to do with this legislation.

Chairman JOHNSON of Connecticut. Well the reason I asked the question is because common sense suggests that these are three means of addressing the same problem, each having slightly different sort of angles to them, but the total of all three of them creating a very complex system that you've already described where some of the benefits in Portman-Cardin will be available to some and not to others. We're still going to drive savings decisions as a consequence of the legal technicalities.

And that really isn't our goal. Our goal is to enhance savings and our second goal is not to subsidize too much savings by those for whom it is easier. So, it seems to me that these three together are really extraordinarily burdensome and what I'm looking for is, is there any way we would go further than the Portman-Cardin bill and simply merge some of these efforts to address the same problems.

Mr. Klein.

Mr. KLEIN. Madam Chairman, I think that the combination of those rules, dollar limits as well as non-discrimination laws, is the functional equivalent of belts and suspenders and I think that the dollar limits themselves are sufficient to meet the stated policy objective to ensure that a disproportionate amount doesn't go to the highly paid, if people accept that as an appropriate policy.

Certainly, the complete repeal of these rules that have had the negative effects that have been amply described by others on the panel, would indeed go further than the very positive step that Mr. Portman and Mr. Cardin have laid out, though their step is definitely a positive one, that at a minimum, should be taken up.

I want to also follow up onto the answer that Ms. Calimafde gave a moment ago to the question on the catch up contribution. Those non-discrimination rules could also be problematic in the large employer context as well, which might drive people to go into this safe harbor if they're eligible for it, where those non-discrimination rules don't apply. I just wanted to underscore that it's a problem across the board potentially—both large and small companies—and I think Mr. Porter had a point on that.

Chairman JOHNSON of Connecticut. Mr. Porter.

Mr. PORTER. Thank you, Madam Chair. It's an observation—as we were going through the bill, as we tried to look at the convolutions caused by the multiplicity of rules and as we applaud the catch up contribution; and then we ask, "How would that work with the rules on maximum contributions?"

And we observe that a woman who reenters the workforce and who happens to be highly compensated, but still missed out on years of ability to contribute, and who happens to make her contribution early in the year, has better chances getting her money into the plan before the nondiscrimination test cuts off contributions later in the year. So you end up with weird situations where a large number of people making contributions in the beginning of the year could affect the ability of other people to make contributions later in the year.

So somehow it seems to me that in order to achieve the greater goal, we need to find a way to keep from hammering ourselves with so many hammers, and perhaps the catch up contributions need to be looked at separately from the other rules.

Chairman JOHNSON of Connecticut. In other words, do I hear you saying that even the dramatic simplifications in the Portman-Cardin bill wouldn't protect us from situations where people have, in a sense, an even access to saving, even in the same plan.

Mr. PORTER. That's correct. Simply by timing within the year and whether you happen to be highly compensated or not.

Chairman JOHNSON of Connecticut. There are so many questions to be asked. Let me yield to my colleague, Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman. With unanimous consent permission, Mrs. Kennelly and Mr. Neal both had opening statements.

Chairman JOHNSON of Connecticut. So ordered.

[The statements of Mrs. Kennelly and Mr. Neal follow:]

The Honorable Barbara B. Kennelly
Statement for the Record
Ways and Means Subcommittee on Oversight
Hearing on Pension Issues
May 5, 1998

I want to commend Ranking Member Bill Coyne for inviting the Theresa and John Heinz Foundation to testify here today on the recent findings of their landmark study for the Women's Institute for Secure Retirement on women and retirement. This important study provides valuable new information for the Committee. In particular, it looks at both younger women and minorities. And the results are disheartening. For instance, a staggering 41% of women and a majority of African-American and Latino women, expect to live at or near the poverty level when they retire. Disheartening but realistic because 75% of the elderly poor are women and elderly women are twice as likely as men to be poor.

As someone who has been working for greater pension equity for women for more than a decade, I am hopeful that the release of this report will help the Committee focus on the unique plight of women and minorities in retirement planning.

I have reintroduced the Comprehensive Women's Pension Protection Act, H.R. 766, which seeks to address a number of the inequities in current law with regard to women. A section by section of the bill follows.

Comprehensive Women's Pension Protection Act

The Comprehensive Women's Pension Protection Act of 1997 introduced by Senator Carol Moseley-Braun (D-IL) and Representative Barbara B. Kennelly (D-CT), addresses a wide array of pension issues affecting women.

TITLE I

•Ends Social Security integration by the year 2000.
•Divides pensions not divided at the time of divorce pursuant to a court order (effectively making the Retirement Equity Act retroactive).
•Clarifies integration with regard to Simplified Employee Pensions (SEPs).
•Provides for the division of pensions in divorce unless otherwise provided in a qualified domestic relations order.

TITLE II

•Allows a widow or divorced widow to collect her husband's civil service pensions if he leaves his job and dies before collecting benefits.
•Allows a court that awards a women part of her husband's civil service pension upon divorce, to extend that award to any lump sum payment made if the husband dies before collecting benefits.

•Allows a spouse to continue receiving Tier II railroad retirement benefits awarded upon divorce upon the death of her husband.

TITLE III

•Requires annual detailed investment reports of 401(k) plans.
•Prevents employers from forcing employees to keep 401(k) contributions in stock of the employer.

TITLE IV

•Provides equal survivor annuities to both husbands and wives.

TITLE V

•Applies spousal consent rules in Retirement Equity Act to 401(k) plans, thereby requiring a spousal signature before 401(k) money could be withdrawn.

TITLE VI

•Gives Labor Department authority to set up a women's pension hotline.
•Authorizes appropriations of up to $500,000 in each of the next four years.

TITLE VII

•Requires pension plans to provide participants with annual benefit statements.

I am hopeful that all members of the Committee will join me in assuring that pensions are safer and more equitable for women. Thank you.

RICHARD E. NEAL
SECOND DISTRICT, MASSACHUSETTS

WHIP AT-LARGE

COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE
SUBCOMMITTEE ON SOCIAL SECURITY

Congress of the United States
House of Representatives
Washington, DC 20515
May 5, 1998

Opening Statement
Mr. Neal of Massachusetts
Hearing Oversight of Pension Issues

Madam Chairwoman, first of all I would like to thank you for holding this hearing today on pension issues. I agree with you that private-pensions are a key element in the retirement security of Americans. We can all agree that we need to improve pension coverage. More retirement savings needs to come from pensions.

We should make it easier for workers to have pensions and for workers to keep their pensions when they change jobs. On April 1, I introduced H.R. 3672, the Employee Pension Portability and Accountability Act of 1998, which is comprehensive pension legislation based on President Clinton's pension proposals in his budget for FY1999. The main thrust of this bill is to make it easier for small employers to offer pensions.

I think it is important that we learn as much as we can about pensions and this hearing provides the appropriate opportunity. We need to remove the barriers to an employer setting up a pension. I look forward to learning about the simplification bill introduced by Representatives Cardin and Portman.

Last year, we improved tax incentives for individual savings by expanding individual retirement accounts (IRAs). The new Roth IRA has given a jump start to savings and we need to do the same for pensions.

Today, we will hear about the Heinz Foundation's Women's Institute for a Secure Retirement and its recent study. This data and the entire hearing is timely as we approach the National Summit on Retirement Savings, at which I will be a delegate.

I hope the Summit will give us the momentum to pass legislation this year. I look forward to working with my colleagues on these issues.

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Mr. COYNE. Thank you.

Mr. Klein, I wonder if you could let us know the proposals you talked about how the retirement security act would affect low and very low wage and salary earners, if it were enacted.

Mr. KLEIN. These are precisely the people who we need to be concerned about—you need to be concerned about. Frankly, I'm not really concerned about the very highly paid. They have ample resources to take care of their own retirement needs. The rules that exist now that would be fixed under the kind of proposals that we've made, under the kind of proposals that Mr. Portman and Mr. Cardin have drafted, really are intended to help the hard working middle income folks, people who particularly may fall just above the threshold of the so-called highly compensated level, as well as people down the line.

For reasons I thought that were quite well articulated by Mr. Walker, often it's the lack of a plan entirely because of the burdensome nature of rules that ends up hurting the lowest paid. It has driven more higher-income and more people into the non-qualified plan arena entirely that lacks all the protection. So, really for a couple of reasons, the changes that are made here would help the lower paid.

First of all, as Mr. Porter noted, the limits that are now in the law are lower in real terms, to say nothing of the inflation affect, than they were 16 years ago. Secondly, the way that plans are funded that look at the projected nature of what a benefit will be in the future, really means that the threshold that now seems to be very high—that seems to only affect highly paid people—really impedes the funding for people of modest wages.

Back in 1993, when Congress considered a change in the compensation limit that could be taken into account for funding plans, and it was lowered from roughly $235,000 a year to $150,000 a year, it sounded like it still was something that was only affecting very highly paid people. Because $150,000 is a lot. We conducted a study at that time that demonstrated that that level would impede the ability of a company to fund for benefits that it has promised to a 30-year-old person earning $35,000, because of the expected increases in that person's earnings over the course of their career.

So these rules are definitely hurting people at the low and moderate wage levels, who are precisely the people that we need to be helping.

Mr. COYNE. And you feel that these proposals that you've talked about would help the earners in the $15,000 to $20,000 and $25,000 a year category, as a result of some of the things that you've pointed out here?

Mr. KLEIN. Yes. It would definitely help people at all ranges. Even if it wouldn't precisely help all people at a certain low income level, it would certainly help them more broadly because it would encourage more plans to be created that would provide benefits to those people who otherwise would have nothing.

Mr. COYNE. Mr. Salisbury, I wonder if you could comment on what are some of the strategies that are being implemented by retirement plan sponsors to encourage more participation in the

plans and to, if they already are participating in the plan, to expand their participation across the board.

Mr. SALISBURY. I think, Mr. Coyne, the first point that you just made, which is related to low income individuals—that since most low income individuals work for small employers and it is small employers that most readily do not have plans. That one of the primary needs is to get more small employers to have plans which will make them available therefore to low income individuals.

What employers are then seeking to do, as most of your defined contribution plans today provide for a matching contribution, most of those plans now make available extensive educational materials and an increasing number of employers now provide direct financial assistance whether it be through video tapes. Nearly 100 percent provide written material that helps people figure out how much they should be contributing.

You're now seeing more extensive use of computer based information as even relatively small firms have access to Intranets within their businesses and the most recent approach as a result of continued efforts by individuals in Congress and the Administration to encourage employers to go the step of not only direct expanded education, but even to make available investment advice, is essentially new Internet-based programs and one-on-one counseling aimed at giving individuals an understanding of how much they need to save in order to have a comfortable retirement.

So you are most aggressively seeing more hands on activity by employers and contracting with third parties to come in and actually meet with employees and do seminars, which is the best way to get positive results.

Mr. COYNE. Thank you very much.

Chairwoman JOHNSON of Connecticut. I—I don't quite understand why sort of the simple idea of limiting the amount that you can contribute to a percentage of your salary, or perhaps also a dollar cap as it does in the current law, 25 percent or $30,000—even if you adjusted that so that lower income people could contribute more or you paired that with sort of a comprehensive catch up piece, so that in periods of high earning when you really could contribute more, you could or maybe you would do that for certain income levels.

Why don't you accomplish the goals of the top heavy provisions and of the non-discrimination provisions if you do that? Why do we have to have the top heavy provisions any more?

Mr. SALISBURY. Chairwoman Johnson, I think Mr. Klein chose words noting that there are many other ways for employers to make sure that high income people get what the employer wishes for the high income people to have.

The research that we've done, including the new small employer survey, underlines the degree to which the more complexity one builds into the system, the more likely an employer—small employer—is to simply not have a plan. It's a reason I would emphasize. That if the objective is to expand the number of plans, to expand coverage, and to expand the number of low and moderate income people with protection, the type of simplification that you just articulated, and getting to the absolute minimum degree possible, the administrative complexity that an employer faces is what is

going to allow the thousand roses to bloom, so to speak. And that simplicity is what is essential from all of our survey research, as well as research done in the academic community.

To a degree that one is concerned about "abuses," as an individual who recently retired after 33 years with one of the largest companies in America doing their compensation planning, his comment was, "ultimately, the high income people will always be given everything they want, even if the company totally and completely grosses them up for taxes."

So to a very large degree, all this complexity, rather than keeping money from going to high income individuals, does not keep that from happening. But it may well cause the employer to think it's not worth the trouble of maintaining a retirement income program that would benefit the low and moderate income population.

Chairwoman JOHNSON of Connecticut. Well, thank you. I think you're absolutely right. The years in which we wrote these pension plans, there was not nearly the creativity in the compensation structure that there is now in regard to ways and means of compensating high earners.

If we don't really radically move on non-discrimination and top heavy rules, we're not going to accomplish anything. We've done this before. We did this with the alternative minimum tax. The alternative minimum tax was great politics. Now it's going to rob families in America of their $500 credit for children.

So, I think we do have to think far, far more radically, and I just wanted to push that point at the beginning of this hearing. Because, you know, 50 percent of the small businesses in America that are being founded today, are being founded by women. And they're mostly very small entities.

But together, collectively, they employ more people than the top 10 Fortune 500 employ. Now the top 10 Fortune 500 have the expertise to deal with top heavy. The 50 percent of the women founded—the 50 percent of the businesses founded by women, have 1, 2, 3 employees, and they have no expertise. So if you ever want to get them into this—and they're smart, they're entrepreneurials, they're making, and so their employees are going to be well paid—if you ever want to get them in, I think we have to think more radically.

When I see before me in this day and age, three provisions that have the same goal—the monetary percentage limits—the 25 percent, $30,000; the top heavy; non-discrimination, it reminds me that we have our heads in the sand. This is not the real world and we have succeeded through those mechanisms in doing exactly what we knew they would have done and we've hidden it from ourselves year after year after year.

Every pension debate I've been a part of, we've made progress. But Congressman Portman and Congressman Cardin have succeeded the larger issue absolutely flat out on the table. And I think it is our responsibility as a committee to look at the real impact, and get ourselves out from under old fashioned rhetoric, and plow through to what do we really have to do if small businesses are going to do it and provide pension plans, and how can we in that context prevent what we all we don't want to do.

But if you limit it to 25 percent or $30,000 cap, or whatever we have to do, and do we need a lower cap—I mean a higher cap—

for low income people and a lower cap for upper income people for equity purposes, or do we just need a couple of things with a good catch up provision that allows the flexibility for the pattern of our lives.

So, I'll yield now to Mr.—let's see, where am I now—Mr. Portman, sorry—I thought I'd gotten further than that—I'm sorry.

Mr. PORTMAN. I'm not going to say anything, because she's not only endorsed the bill, she's gone way further. So this is great. We can all go home. No, I really appreciate all the work you all put into this and, Chairwoman Johnson, your enthusiasm is fantastic.

The philosophy behind what we've tried to do the last few years really is spelled out by Mr. Salisbury, and it's a very simple philosophy. And that is, that you can expand coverage greatly by reducing the burden, the cost, the liability, the risk of liability that Mr. Walker and others talked about. And it works.

I think the information we're getting in from the field on the SIMPLE plan is a great example of that. I think in the next several months we're going to have some amazing data on that—on the hundreds of thousands of people who are now covered by retirement savings plans who never were before. And I hope it will provide, at least, the general philosophical framework for this Congress to go much further.

Let me just get in a couple of other issues, if I could. One thing is the cost to all this. To be honest, as a fiscal conservative as most of us are now, we have to recognize that there will be revenue cost to all this. Most of these rules—you're right, Mr. Klein, are kind of like a belt and suspenders—which is why we go into the detail we do on eliminating all together the 25 percent rule, raising the limits, raising the deferral, modifying the top heavy rules significantly—although, we could go further than that—and also clarifying and modifying non-discrimination rules. Generally, we do that in this legislation already.

But, one reason on the limits, as an example, we are somewhat constrained, is that there is a cost to it. If there was no limit at all, it would be even a greater revenue estimate, which we would have to then compensate for with some kind of tax or entitlement program changes. So, there are some other limitations here. We just need to be cognizant of, to be honest about this, and we'll see how far we can go.

I think one thing Mr. Klein has done well is to spell out how these so called tax expenditures, which is what they're called in the field, do actually benefit not just the individual workers, but the economy. And that's something we're trying to get the Joint Tax Committee, of course, to focus on. To do more, as we always say, dynamic scoring. And, Mr. Klein, because I raised the issue, you might just touch on that quickly, and then I have a couple other questions.

Mr. KLEIN. Yes, I agree and I think I would make this comment about the tax expenditure and the revenue loss that obviously you, as responsible members of the committee, have to consider.

As I said in my opening remarks, I do believe that this is a tax expenditure that is fundamentally worth it—and my written statement talks about how the evidence of the tax expenditure being heavily weighted toward more middle income people. Mr. Salisbury

has done a study in this regard, and another respected researcher—Sylvester Schieber has done work in that respect.

So it really is a tax expenditure that is aimed at, if you will, the right people who need it. That's number one. Number two, we need to consider the way the tax expenditure is calculated. I testified before this subcommittee a couple of weeks ago on the health care tax expenditure. And I made the point then that I thought it was a bargain for not only the individuals covered by health plans, but for the U.S. treasury, because it would be so much more expensive to provide those benefits directly to the people.

It's even more the case in the pension arena. The evidence is there to show the bargain that it is for workers and their families and the government. But also, unlike the health care tax expenditure, on the pension side, of course, this is money that is ultimately recaptured. And we're coming near a phase, over the next number of years, where a big bubble of the baby boomers are going to begin to retire, and we'll be paying tax on those benefits that we are going to be receiving. And that should help the tax expenditure loss figure considerably.

The other point, of course, that is special about the pension tax expenditure, is that it provides the capital necessary to make the economy grow. And that in turn leads to other tax collections.

Mr. PORTMAN. Right. Your full statement is part of the record and those who haven't seen it, it is a good analysis of that. I think it's important to get that in the record, because that's a hurdle we'll have to face.

Let me just briefly touch on the contribution limits and on the 25 percent rule, because I'm not sure it was as clear as it could have been. Mr. Walker talked a lot about the rank and file workers versus the fat cats, as you said. If I could just ask one question and get it on the record. Maybe, Mr. Walker, you could respond and Mr. Porter, or Ms. Calimafde. How does increasing the contribution limits help those people who are rank and file workers save for retirement? What would the impact be on this?

Mr. WALKER. For example, right now—and incidentally your bill, taking the currently $160,000 limit back to the $235,000, will be very helpful—because at $160,000, if you have a 401(k) plan and an employer that has a 50 percent match on the first 6 percent of pay, the guy that owns the business can't even get the 50 percent because of the fact that you can only count the first $160,000 of compensation.

So obviously, those kinds of increases in the limitations are going to do great things in terms of enticing that owner to take advantage of the possibility of doing some more things for himself. But, in that same process, bringing everyone along with him obviously, because they are going to go to the safe harbors. Which means they are going to include everyone in that circle.

The difficult part of this was hit on by Jim and others. The owner will find a way—if nothing else, the business itself is typically a pretty good retirement plan for a lot of those business owners. And so their desire to do things for themselves, greed if you'd like, is going to have a significant impact on what they do for their employees as well.

Mr. PORTMAN. I know my time is up. Mr. Porter may want to answer, if the chair will indulge me.

Let me say that there are some relatively controversial issues in this bill that I would like to have had time to get into and perhaps we'll be submitting written questions to you all. But I appreciate all the great input today and a lot of you complimented the legislation. I know you don't agree with every aspect of it and again, Chairwoman Johnson has raised some important new questions. We could go even further.

But one that I do want people to talk about is this—the SIMPLE plans versus the 401(k) and where we should go on the limits. I think, Paula, you had some thoughts on that earlier when we talked. But I think there's some issues here—whether there should be this disparity between the defined contribution plan, the defined benefit plan, and so on. So we do look forward to continuing the dialogue.

I don't want everyone in this room to think that this is a lovefest. There are some issues here we had to work through over the last several months, and I think we came out where we probably should. But we want your continued input.

Mr. Porter, would you like to finish?

Mr. PORTER. Just briefly, two issues. One is, it's obvious from a lot of studies that, as people go through their life, they're net debtors during their early years of out of college and in the work force, and as they approach retirement, they start concentrating their savings.

And as much as you, our leaders in the Nation, have to be concerned about what happens when the baby boom bus hits retirement age, as employers we're concerned that as our workforces reach those ages when they're in the prime years of being able to save, that they be able to put in what they feel they need to approach their retirement.

And on the defined benefits side, unfortunately, there are times when jobs get eliminated and people have to leave the workforce before they had really wanted to. And we're seeing surprising numbers of individuals who are not highly compensated but who have their defined benefit plan benefits limited because they are retiring at early enough ages that the limits come down and reduce their benefits.

Now, for people in larger corporations where there are benefit restoration plans, at least they're held whole by their employers, but it's not all secure. So, two instances that increased limits help the rank and file employees are those situations where they're ready to save and can't and those situations where their job is eliminated and their full benefit cannot be paid from a qualified pension plan.

Mr. PORTMAN. Thank you. Thank you all for all your help.

Chairman JOHNSON of Connecticut. Thank you. Mrs. Thurman.

Mrs. THURMAN. Thank you, Madam Chairman. Mr. Klein, in your testimony on page four, you talk that there had been a comprehensive study of administrative cost for large and medium and small plans, and how much that's grown in all of those different areas. Can you give us some examples of what you're talking about in administrative cost? Is that just the complexity of the tax laws?

Is that some of the charges that we put on up to the $19? Can you give me some examples?

Mr. KLEIN. Sure. And that was drawn from a study by Ed Hustead from the Hay Group and I'd be more than happy, if you'd like, to submit the entire report—it's not very long—for the formal hearing record.

The study really addresses a number of the different requirements resulting from years and years of legislative items that were mentioned on page three of my testimony—specific major pieces of legislation aimed at extracting revenue from employer sponsored retirement plans. It includes such things as the cost of a plan sponsor being advised by their professional advisors and attorneys as to the nature of the changes in the law caused by Congress or the regulations from the regulatory agencies. It includes the expenses involved in amending plans. It involves the expenses involved in communicating these changes to participants. It involves, on the defined benefit side, the additional cost of the Pension Benefit Guaranty Corporation premiums.

Interestingly, the study, and to this extent I must correct myself, I might even have understated the point. The study that Mr. Hustead did actually relates to the ongoing administrative costs; not actually to the additional costs of implementation of the changes themselves. So the result of those rules in an ongoing fashion, that is reflected in these very devastating numbers. It would be even worse if you added to that the actual implementation cost of making specific changes to the law and amending the plan.

Mrs. THURMAN. In the solvency, I believe of that fund and some of the problems it had placed a couple of years ago. I wasn't here at the time, but I understand there was a rather large deficit because of pension plans going broke and then, of course, some other things happened. I don't know how we address that from making sure that people who have invested are protected in those cases. So I'm not sure that's one we can do much about. Maybe you have a different idea, and if you do, please elaborate, somebody?

Mr. KLEIN. Well, you know, there have been a lot of comments being made today that may, perhaps, have beaten up somewhat on Congress for some of the complexities that have been caused. Certainly, one of the things that Congress has done well is to shore up the fiscal difficulties faced by the Pension Benefit Guaranty Corporation in previous years. And the PBGC reports a very robust financial situation now. It might be even something for Congress to contemplate, since the chairman has suggested thinking radically, of perhaps lowering some of those PBGC premiums, as appropriate, to help encourage the growth of plans, particularly, in the small sector.

Mrs. THURMAN. With that in mind, and for anybody, in the bill that's been discussed today, do you see where this bill will make those administrative costs less?

Ms. CALIMAFDE. I can speak to that on behalf of small business. There is one provision after another in this bill which strips away unnecessary complications. So, for instance, in the top heavy area, yes, it keeps the top heavy rules. And I understand where the Chair is going on this. The top heavy rules are largely duplicative of all these other rules. But there are still groups out there in this

town, they may not have great technical expertise in this area, but they think the top heavy rules give great benefits to common law employees. So, you know, you're dealing with a perception not reality there. But the way it has stripped down some of the complexity in the top heavy area will certainly help out.

The 401(k) safe harbors, I believe, are going to change radically how the whole 401(k) plan is perceived by small business. And this bill, that we're talking about today, opens up both safe harbors to small business. Before this bill, only one safe harbor was available to small business. This bill also opens up the match. So, I think there are dramatic changes which would make it much easier for small business to sponsor a plan in a cost effective fashion.

Mr. WALKER. And yet, regarding the small business, the small business is still going to have to test for top heavy and that—there's a cost involved in doing that because most employers are not capable of doing that by themselves. And when you have a facts and circumstances situation where you have every employee of that employer being treated exactly the same way, i.e., the contribution is the same or the benefit from a defined benefit plan is exactly the same, then imposing an additional administrative burden when common sense tells you this is not a discriminatory plan because every employee is being treated equally creates a roadblock, in the minds at least, of many employers for the establishment of a plan.

Mrs. THURMAN. Thank you.

Chairman JOHNSON of Connecticut. Mr. Weller.

Mr. WELLER. Thank you, Madam Chair, and I'd like to focus my questions on the issue I brought up in my opening statement regarding the pension limits of Section 415 on multi-employer pension plans. And it's kind of interesting about this particular issue is this is an issue I've heard about over the last several years that I've had the privilege of serving in Congress, and it has come up at town meetings and various gatherings throughout the district that I represent. Usually it's brought to my attention by the spouse. You know, the wife who's watched her husband who has for a lifetime—who has gone out every day and has been finishing cement, or building housing, or putting up structural steel, backbreaking work. And, of course, in good times they've made more money and put more money into their pension plan. But then when it's time to retire, they discover that promises made aren't necessarily kept under the full pension that they thought they were going to earn with the 415 limits.

And I'd like to just direct a few questions, perhaps, I should direct to Mr. Klein and Mr. Salisbury and if other members of the panel would like to answer them, but just so we can fully understand this issue. Mr. Klein, am I correct that the Section 415 limits are not preventing rank and file workers covered by multi-employer plans from receiving full pensions that they would otherwise receive under their plans?

Mr. KLEIN. Yes, I think it's applicable in both the multi-employer and the non-multi-employer context, and that's actually one of the virtues of the Portman-Cardin bill in terms of some of the relief that it accords in the Section 415 arena.

Mr. WELLER. Mr. Salisbury, do you have anything to add to that?

Mr. SALISBURY. It, both in terms of the actual benefits paid, you are correct as well as the 415 limits, as Jim mentioned, for all plans do affect the amount of funding that can be done in those plans which is an interesting juxtaposition to what the Congresswoman was raising regarding the Pension Benefit Guarantee Corporation that we have an agency to ensure and guarantee the benefits of defined benefit and defined contribution plans. Yet, because the 415 limits do not allow for projection of salary increases, we have laws that make it very difficult for pension plan sponsors to fully fund those benefits when they do want to provide them.

Mr. WELLER. So, then it's safe to accept the base limits of Section 415 for defined benefit plans are not designed for multi-employer plans whose benefits are not based on a worker's wages or salary, is that correct?

Mr. SALISBURY. Well, a defined—most of your multi-employer plans are not the same type of formula. You're correct as a single employer plan. One would say they were designed for them in the sense that Congress explicitly knew they were applying them to defined—to multi-employer plans. But they do, you are correct, have a slightly different effect and impact because of the nature of the benefit formula. That can also, however, apply to some large single employer plans. For example, the plans of companies like General Motors that have the same type of benefit formula as a building construction trade's multi-employer plan. So, again, these are—these are the types of provisions that impact many pension plans across the board in terms of benefit delivery and funding.

Mr. WELLER. Do other members of the panel have any responses to those questions?

Ms. CALIMAFDE. If I could go off multi-employer for one minute and talk about how this bill would repeal the 25 percent of compensation limit in section 415. That is a section that really hurts lower paid employees. In my own law firm, for two years now, one secretary and one paralegal that had 401(k) contributions returned because of the 25 percent of compensation limitation test. So that is one real life area that I can tell you will really affect a lot of staff employees and help them to be able to put more into the 401(k) plan. I mean, it almost serves, well, it does serve a very negative purpose right now.

Mr. WELLER. Well, it's kind of an issue of fairness. You know, in good times, if someone is working overtime, working extra hours during the week, perhaps working for a different contractor on a weekend, making extra money. This is an opportunity for them to set aside more during those good times, and it's kind of fair, I think, if you put in more, be able to take more out. That's an issue of fairness and, of course, Congress has recognized that with firefighters and other public employees in other pension programs.

Let me just ask this, perhaps, Mr. Klein, you know, if we were to lift this Section 415 pension limit on multi-employer plans, would it jeopardize these funds in any way?

Mr. KLEIN. Well, I really don't see how because the effect of the rules is to really curtail funding of benefits. So to the extent we can ensure greater funding, greater security, greater benefits being paid, that should serve to benefit all.

Mr. WELLER. And would we give these participants in these multi-employer pension plans any special benefit that anyone else is not receiving? Are we doing anything special if we limit these limits an exception since we've done this for other pension plans?

Mr. KLEIN. I'm sort of coasting into a territory that I would want to reflect on and answer to you, following up in writing. Nothing immediately comes to mind that would draw any distinction. I think as a number of us have said, the effect of the rules really are negative on all types of plans, multi-employer as well as single employer, and the rules definitely are problematic as they apply to the single employer world as well. And it's not that I think that there's any special, favorable treatment in the single employer world at the present.

Mr. WELLER. Mr. Salisbury, do you have anything to add?

Mr. SALISBURY. Well, I think as you noted, the Congress did act to change these rules for governmental plans and incremental is incrementalism and they do have an impact on funding. One of my early testimonies before this committee 20 years ago was when we completed the Multi-employer Amendments Act Study at the Pension Benefit Guarantee Corporation, and at that time, there were recommendations that encouraged Congress to find ways to expand funding of multi-employer plans which were severely under-funded at that point in time.

Mr. WELLER. Okay, thank you. Madam Chair, thank you very much. And it's my hope as we work to improve our private pension system that we address this issue which affects millions of Americans in the building trade. And, again, I appreciate your support of this issue.

Chairman JOHNSON of Connecticut. Before I dismiss this panel, since you spent a lot of time being very nice about the Portman-Cardin bill which is really an excellent piece of legislation and proposal, would you like to briefly point to parts of it that you think are particularly good or around which there are still controversies that we should direct our attention to?

Mr. KLEIN. Well, I would just say because I think it's part of our responsibility to point out areas in which there might be controversies, that clearly, the revenue issue is one area as Mr. Portman mentioned. I hope that my earlier answer is valuable and one that I would hope members agree with. I think that we really have to stop in its tracks, Madam Chairman, this notion that retirement plans somehow exist to help the very highly paid. I think if one thing has been forthcoming from the testimony today from the entire panel, it's the effort to which employers go to provide these benefits and the extent to which these rules really are hurting the lower paid. I think that issue just needs to be taken on directly. You've challenged everyone to think in more radical ways and I think that's important. And I think that there's just ample evidence that the rules have hurt the wrong people, if you will, that they have not helped the people they were intended to help.

Chairman JOHNSON of Connecticut. Anyone else wish to comment?

Mr. SALISBURY. Madam Chairman, rather than commenting on the bill per se, I just make a notation on the tax expenditures issue and the calculation methodology. It was developed when most of

the system was a defined benefit system. In the defined contribution realm where we're talking about this really being employee money going in, employee money coming out, with very fast vesting in most cases. If they're invested in equities, then they're basically taking out after 20 and 30 years most of the money coming out is from investment earnings, it is not from their contributions. They're being taxed at regular income tax rates as they take those capital gains out, whereas if they were saving that money outside of a qualified plan system, under the last year's tax act, they would be paying much more favorable capital gains tax rates. So, in essence, if one looks at that in the calculation of defined contribution tax preferences, we've done numbers that one can actually find that there is a revenue gain for the Government the more savings goes into qualified plans as opposed to being done outside of qualified plans to the degree that money is invested in equities.

And today about 60 percent of all defined contribution assets are, in fact, invested in equities so people are actually paying higher taxes, not lower taxes ultimately over the lifetime as a result of the current tax treatment. That is totally and completely ignored by the Treasury Department, the Office of Management and Budget, and the Joint Tax Committee when they do their tax expenditure calculations.

Mr. WALKER. And as somebody who has been around a long time, one improvement I might suggest in the $5,000 add-on contribution is how about a 10 to 15 year look-back? You know, I'm getting awful close. [Laughter.]

Chairman JOHNSON of Connecticut. OK, Mr. English.

Mr. ENGLISH. Madam Chair, I stated in my opening remarks of the three years that we particularly focused there's nothing about the bill that we find to be objectionable at all. We find the bill to be a fine piece of legislation.

Ms. CALIMAFDE. I just want to mention that the excluding 401(k) contributions from the 404 15 percent deduction limit will go a long way because, again, that works to cut back common law employees often. Another change I thought was very good was bringing the required minimum distribution date, that's when you must start taking money out of the retirement plan from 70.5 to 75 but for 5 percent owners, they have to start taking out 75 if they keep working. And I don't—I can't come up with a rationale why a 5 percent owner has to take out money while he or she is still working when everyone else can keep on and they don't have to take the money out.

One thing I think we should try to accelerate faster is this repeal of the 150 percent of current liability funding. This goes to define benefit plans. This is a real problem for small business because they're not allowed to fund the retirement plan in a level fashion. And for a typical small business, the swing of $100,000 or more, for the defined benefit funding is tremendous. So if we could speed that up.

And I want to make one comment. I heard one of my panelists say, fellow panelists say, well, you know, the owner of a small business, their retirement is the business. And I want to take issue with that. There's a lot of small businesses out there that will not be able to be sold. In many cases, retirement for that small busi-

ness owner is the retirement plan which is why so often retirement plans that are sponsored by small business are very strong plans. So, you know, I wish it were true. Unless what you meant was the small business owner gets to keep working for the rest of his or her life, which I think may be really true. But the bill, overall, is really a very strong bill, I think, for retirement plans.

Chairman JOHNSON of Connecticut. Will the business community object to the faster vesting period, the accelerated vesting from five to three years?

Ms. CALIMAFDE. Well, some of the business community is going to. Remember, small business is already stuck with these vesting schedules because of the top heavy rules. You know, I've always felt that why should small business have faster vesting than everyone else? So, I think the longer vesting schedule is better. I know at the White House Conference on Small Business there were a number of delegates who made the comment that it's not fair that vesting is so fast. For instance, comments were made such as, "Why are my employees fully vested after three years when in a larger entity they're vested after five years?" You know, five years seems fast enough. So, it's almost a non-issue for small business but I'm sure for mid-size and larger it's a significant issue. Also, remember that many small businesses don't even offer a match because it doesn't count for top-heavy purposes. Small businesses often just make the profit sharing contribution instead. The ultimate result of faster vesting could be smaller matches so that employers who would be affected by this change would keep costs constant.

Chairman JOHNSON of Connecticut. But in a sense, the sector that would have the most difficulty adapting to it already has it. Mr. Porter.

Mr. PORTER. One, Madam Chair, I would like to mention that we've heard a number of testimonies dealing in particular with smaller business and with how the complexity of the law discourages plan sponsors. For the larger corporations, in many cases, their interest is to do what's right for the employee. And they're going to do what's right regardless of how complicated it is. We're in the process of a major re-tooling of how we administer our benefits, and the common frustration expressed by the business leaders, who don't understand ERISA, is that somehow the people who are working in benefits administration are engaging in some sort of technological lovefest. [Laughter.]

And it's a big issue. There's no suggestion that the benefits ought to be curtailed. There's no consideration that they don't want to provide benefits to people. The consideration is that it's a tremendous waste of money, and time, and effort, and manpower of talented people who could be doing very productive things for the economy to have to deal with all of this. And I think that's where we would come off in the vesting issue. We're more concerned, mostly concerned about being able to provide what we want to provide for our employees in a cost-effective manner.

Chairman JOHNSON of Connecticut. Interesting. Mr. Portman.

Mr. PORTMAN. Just quickly, the faster vesting, of course, is because of the increasingly mobile workforce. We tried to address that and I think you make a good point that that's already a re-

quirement for smaller business and that I'm not hearing much from the larger businesses on that. But something we did struggle with was the 5 percent owner rule. That was one, frankly, I agree with you on. We did get comments on that one. And, frankly, we did not have time to work through some kind of anti-abuse rules and, that's one we might want to revisit. I think you're right I don't think it's consistent with the rest of the legislation.

Let me ask you one more question, quickly, since Chairwoman Johnson has given us this opportunity about the salary reduction SIMPLE plan. Now, this is the ability really to go to a very simplified plan where the employee would be able to set aside, or the employer, $5,000 into an account, with no matching. Do you have concerns about that? This is one others have raised as a concern that, as an example, could be used by owners simply to provide for themselves, not having any contribution requirements. Does that concern any of you on this panel?

Ms. CALIMAFDE. Well, it breaks ground with any retirement rule we've had to date, the SIMPLE plan broke ground, but the company still had to match. So this is the first retirement plan where the company would have to do nothing at all.

I know the SBCA and the SBLC are a little concerned in that this is really an IRA. The SIMPLE is really an IRA plan and employees can access that money by simply going to the bank or the brokerage house and say they want to withdraw. There's a 10 percent penalty for that withdrawal but that doesn't seem to be much of a barrier. What I liked about the legislation is with the SIMPLE salary reduction only, it'd set a $5,000 limit and then the SIMPLE regular plan was, I think, a $10,000 limit.

Mr. PORTMAN. Raised from $6,000 to $10,000.

Ms. CALIMAFDE. Right, you jumped up to $10,000.

Mr. PORTMAN. So there's a disparity.

Ms. CALIMAFDE. And then 401(k), you went from 10 thousand to 15 thousand. So, it would seem to me, you're giving an incentive for a company to move out of what I would consider the IRA area into the true qualified retirement plan area. And so I think it's an interesting idea. Hopefully, it will bring more small businesses to the table and ultimately get them to the 401(k) area which is a huge success story. In our firm, that one paralegal I was telling you about, who was cut back by the 25 percent of compensation test, that paralegal in eight years, with employer contributions, and her own 401(k) savings has an account balance of $84,000. You know, you just can't beat that kind of story.

Mr. PORTMAN. You're okay with the $10,000 as compared to the $15,000 on the 401(k), do you think that's adequate?

Ms. CALIMAFDE. Yes, what I was saying is I think the gap is what's very important——

Mr. PORTMAN. Yes, that's important.

Ms. CALIMAFDE [continuing]. Because I do think the 401(k) is a much stronger plan because the employees can't access the money easily. So it has forced savings and what we're seeing with all the data is that, in fact, most employees will not go to the employer to get a loan or get a hardship distribution unless they really need it. So, the money is staying in the plan and the trick, I think, to saving is once an employee gets a good account balance statement

then he or she really enjoy seeing the money grow, and they like these 800 numbers, and they like getting to pick and choose between mutual funds so it's actually the 401(k) that is engendering a lot of excitement among the employees.

Mr. WALKER. I think, incidentally, that will be a great first step because you have the two year rule, they can't have had a plan for the prior two years so basically what you're going to draw into the pension marketplace are employers who do not have existing plans and have not had them. I think that's great.

Mr. PORTMAN. Okay, well, that's certainly is our intent. It's trying to get those employers who have nothing at all. It's a lot better to have that rule than no ability at all to save. So we think it's a good step but it is a change in direction. And I think one that's going to be somewhat controversial. Thank you.

Mr. WALKER. Madam Chairman.

Chairman JOHNSON of Connecticut. I think it's an important step, too, because it gives employees an opportunity to start the savings habit, whether their employer can afford to participate or not. And with a number of very small businesses out there that in two years are going to be a little bit bigger businesses, I think it's very, very important to start, to initiate the savings habit as early as possible. And I think once the employer has started in it, he'll want to be able to maintain that participation and move to the next step.

Thank you very much for your help this afternoon, and we'll look forward to working with you as we develop this legislation. Also, if any of you really want to participate with me in thinking outside the box, to repeal my word, "radical."

Mr. KLEIN. I have one for you right now.

Chairman JOHNSON of Connecticut. Substitute——

Mr. KLEIN. I can tell you in 20 seconds or less. A lot of these rules that we're talking about have been designed to deal with problems, either real or perceived, in the small business area. And yet they are applicable to the large businesses represented by my group and by the group that Mr. Porter represents here. So in thinking about relief, you can't forget about the problems that these rules cause unintentionally to large business. And if you want to really think outside of the box, if there's going to be exceptions for small businesses in all sorts of non-pension areas, maybe pensions is an area which there should be exceptions for large companies.

Chairman JOHNSON of Connecticut. Well, I really do urge you to think outside of the box and come up with, you know, the outline of proposals so we can look at them, and start talking with them because, you know, we really, you don't often really modernize the law. And the Portman-Cardin proposal is really a dramatic effort to modernize the law. I think we also, at the same time, need to think outside the box, and what would we do if we were starting from scratch because we now understand, first of all, the extraordinary urgency, the real urgency of getting Americans to save. Social Security is a totally inadequate retirement income and now people are spending a career in retirement. All of us will live longer in retirement than we lived at home with our parents. [Laughter.]

That was a lifetime when you were 16 and 18. And we're all going to experience 20 years of retirement, pretty much, at least. So, we really can't any more have Federal laws founded on, in a sense, defensive assumptions. We really have to do things to force everyone in our Nation to participate in retirement planning. And that's what we did in the 401(k), and all the enlargements of all those things. So we have now a sort of anachronistic pension structure underneath all of those other vehicles and really, if we're worth our salt, we'll think more broadly.

Thanks.

Ms. CALIMAFDE. Thank you for your efforts.

Chairman JOHNSON of Connecticut. Mr. Jeffrey Lewis, the executive director of the Heinz Family Philanthropies; Cindy Hounsell, the executive director of the Women's Institute—if you could proceed?

Okay, it's just been announced that there'll be a series of five votes starting at 5:15 which means that we really ought to try to get everybody's testimony in before that time. So we're going to have to be, we're going to have to stay within the time frames, and target our questions.

Mr. Lewis.

STATEMENT OF JEFFREY LEWIS, EXECUTIVE DIRECTOR, HEINZ FAMILY PHILANTHROPIES

Mr. JEFFREY LEWIS. Thank you. Madam Chair, Congressman Coyne. I am Jeffrey Lewis, executive director of the Teresa and H. John Heinz III Foundation.

I was the Republican staff director for the late U.S. Senator John Heinz, who as, you may recall, was devoted to these ssues, and up until the day he was tragically killed, was working on pension legislation. I know if the Senator were alive today, he would be in the thick of the discussion on Social Security reform as well as the challenges of improving the private pension system. Teresa Heinz, chairman of the Heinz Family Philanthropies, made it her mission to ensure that part of the foundation's focus is to finish some of the visionary work with which the late Senator was involved.

I deeply appreciate the opportunity to be here this afternoon to discuss the results of a national poll that we recently completed. During the past several months, the Heinz Foundation joined with SunAmerica Corporation to undertake the historic National Women's Retirement Survey. The objective of the poll was to target women aged 25–55 to better understand what women, in and outside, the workplace were doing to prepare for retirement, and how they personally address these issues. A total 1,858 people were interviewed and we over-sampled for African-American and Hispanic American men and women.

Although many Americans would ideally like to retire early, most know realistically they will have no choice but to work at least until age 65. In fact, for one half of Americans aged 25 to 55 there may be no such thing as retirement as we know it. Nearly half of all the respondents say they expect to have to take on a full- or part-time job after they retire in order to support themselves.

The general polling results underscore the fact that Americans share a fear about the financial survival of Social Security. Only

1 in 20 Americans believe Medicare and Social Security will definitely be there when they retire. However, our findings point to a much larger and more troubling issue that we are facing in America today, a retirement savings crisis. A crisis where first far too many low-income Americans, particularly, African American and Hispanic Americans, are working in settings where pensions simply are not offered, second, they are financially unable to participate in pension plans if they are offered, and third, they are not making enough to save on their own.

Here, we believe we have done something very different. Our goal was, in particular, to begin to understand what African Americans and Hispanic Americans are and are not doing with regard to savings and pension issues generally.

Let me share with you four specific results:

Number one, 75 percent of African-American women and 69 percent of Hispanic women report that they usually have little or no money left after paying their bills to save for retirement;

Second, 71 percent of African American women and 59 percent of Hispanic women are concerned that they will simply not have enough money on which to live when, and if, they retire.

Third, while there continues to be a debate about the issue of raising the retirement age for purposes of eligibility for Social Security, for many African-American and Hispanic-American women this is really a nonissue. Sixty percent of African American and 57 percent of Hispanic women expect to have to continue to work at a part-time or full-time job after retirement simply to survive.

And, finally, Hispanic Americans are the most likely to be employed in jobs where pensions are not offered. Madam Chair, minority women are not optimistic. They are short on finances and increasingly inclined to believe that they will never have the power to control their financial destinies. Since many do not have enough money to make ends meet while they're working, they cannot fathom a time in the future when they will not be working. They fear that retirement for them will represent a financial prison. Fifty-seven percent of African American and 54 percent of Hispanic women fear they will live at or near the poverty level after working long and hard throughout their lives. If these trends continue, not only will poverty and old age continue to have a distinctly feminine face, but the feminization of poverty will have gained a greater stranglehold on women in general and minority women in particular.

Let me summarize my remarks in that way, and ask that they be placed in the record in their full. And thank you for the opportunity to be here, and, most importantly, for the leadership of this subcommittee. It is rare that we can have such bipartisan strength on these kinds of issues, and it's wonderful to see it going forward.

Thank you.

[The prepared statement follows:]

TESTIMONY OF JEFFREY R. LEWIS
EXECUTIVE DIRECTOR, HEINZ FAMILY PHILANTHROPIES
Subcommittee on Oversight
Committee on Ways and Means
Hearing on Pension Issues
May 5, 1998

Madam Chairman, Congressman Coyne, members of the Subcommittee, I am Jeffrey Lewis, Executive Director of the Teresa and H. John Heinz III Foundation.

As you may be aware, I was the Republican Staff Director to the late U.S. Senator John Heinz, a Senator devoted to retirement issues and who, up and until the day he was tragically killed, was working on pension legislation. I know if he were alive today, he would be in the thick of the discussion on Social Security reform as well as the challenges of improving the private pension system. Teresa Heinz, Chairman of the Heinz Philanthropies has made it her mission to ensure that part of the foundation's focus is to finish some of the visionary work with which the late Senator was involved.

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Eye-Opening Results:

Although most Americans would ideally like to retire early, most know realistically they will have no choice but to work at least until they are age 65. In fact,

for one half of Americans aged 25 to 55 there may be no such thing as retirement as we know it. Nearly half of all respondents say they expect to have to take on a full- or part-time job after they "retire" in order to support themselves.

The general polling results underscore the fact that Americans share a fear about the financial survival of Social Security. However, our findings point to a much larger and more troubling problem that we are facing in America today, a pension crisis – a crisis of far too many low income Americans, particularly African-American and Hispanic Americans, working in settings where pensions simply are not offered; and being financially unable to participate in pension plans if they are offered.

Here, we believe we have done something very different. That is, our goal was, in particular, to begin to understand what African-Americans and Hispanic Americans are and are not doing with regard to savings and pensions issues in general. While I will be happy to respond to questions about the poll, my testimony today will focus specifically on what we found among African-Americans and Hispanic Americans, both men and women.

What we found was a race to the bottom.

Let me share some of the highlights that examine these issues:

1. **No money for retirement**:

75% of African-American women and 69% of Hispanic women report that they usually have little or no money left after paying their bills to save for retirement;

2. **Fear they won't have enough money to live on:**

71% of African-American women and 59% of Hispanic women are concerned that they simply will not have enough money on which to live when and if they retire.

3. **No real retirement**:

While many in Congress, the Administration and the news media have and continue to debate the issue of raising the retirement age for purposes of eligibility for Social Security, for many African-American and Hispanic American women, this

is a non-issue! 60% of African-American and 57% of Hispanic women expect to have to continue to work at a part-time or full-time job after retirement simply to survive. For them, there will be no retirement because they fear that they will not have saved enough money to live on.

Madam Chairman, minority women are bereft of optimism, short on finances and increasingly inclined to believe that they will never have the power to control their financial destinies. Since they barely have enough money to make ends meet while they are working, they cannot fathom a time in the future when they will not be working. They fear that retirement, for them, will represent a financial prison because so many -- 57% of African-American and 54% of Hispanic women fear they will live at or near the poverty level after working long and hard throughout their lives. If these trends continue, not only will poverty in old-age continue to have a distinctly feminine face, but the feminization of poverty will have gained a greater strangle hold on women in general and minority women in particular.

Chairman JOHNSON of Connecticut. Thank you very much, and thank you for your good work in this field.

Ms. Hounsell.

STATEMENT OF CINDY HOUNSELL, EXECUTIVE DIRECTOR, WOMEN'S INSTITUTE FOR A SECURE RETIREMENT

Ms. HOUNSELL. Yes. On behalf of the Women's Institute for a Secure Retirement, I want to thank the members of the subcommittee, and particularly Chairman Johnson and Representative Coyne for inviting us here today.

WISER's primary mission is education, providing women with information and the retirement planning skills so that they can surmount the overwhelming challenges to securing retirement income. Our goals include increasing awareness among the general public, policy-makers, and the business community of the structural barriers that prevent women's adequate participation in the Nation's retirement systems.

Instead of reading the entire text of my statement, I'd like to highlight certain points:

Retirement challenges for women workers: three out of four working women earn less than $25,000 per year. Half of all women work in traditionally female, relatively low paid jobs without pensions. Women are more likely to work in part-time and minimum wage jobs without pensions. Women's earnings average 74 cents for every $1 earned by men. Women retirees receive only half the average pension benefits that men receive. Women spend 15 percent of their careers care-giving outside of the workforce compared to less than 2 percent by men.

Reasons why women need more retirement income: women live longer than men. They earn less so their Social Security and pension benefits are smaller. Women are likely to be widowed or divorced and not remarry. Non-married women are more likely to be poor. Women, because they live longer, are more likely to need long-term institutional care.

Over the past 15 years, there's been a shifting of the burden of retirement from the employer to the employee. A trend that will almost certainly have a disproportionate effect on all low-wage workers, but particularly women for the following reasons: as low-wage earners saving for retirement, women are clustered in low and middle income households. The median income for all working women under age 65 was less than $15,000. For full time women it was less than $25,000. The fact that women earn 26 percent less income than men creates less of an opportunity for savings. It means they have substantially less income to put in an IRA or 401(k) savings plan. And that means their pension benefits are going to be less than men's. Consider the statistic that for workers over age 40, the average woman has accumulated only $7,000 in her 401(k) plan whereas the average man has accumulated $20,000 in his.

A recent USA Today survey of the Nation's largest employers found that the worse plans are offered in the retail and service industries the sector where the workers are less likely to have pensions, the pay is low and the jobs are dominated by women. The survey's results indicated that the workers least able to save also

have the lowest savings—and the lowest matching contributions by employers.

Given these basic facts, what I'm about to say may be perceived as controversial but is not meant to be so. And I understand that people over 50 often need to have extra time to catch up because earlier in their career they were not able to contribute. But we also have to be candid when we talk about pension reforms and who they're going to benefit. I've spoken with thousands of women in the past few years and not a single one has complained that she cannot put enough money into her 401(k), or that she needs a catch-up provision. And those are the women that I'm most concerned about today. In fact, it's exactly the opposite. As the National Women's Retirement Survey indicates, most working women are trying to juggle their finances just to find some income to contribute. And low wage working women that I talk to simply wished that they had some sort of a pension. Expanding savings opportunities by increasing contribution limits or creating catch-up contributions may not have much effect on the women we are most concerned about, the majority of America's working women who earn less than $40,000 per year. What will help these women? Simplified vehicles, like SAFE, that provide immediate vesting and a special focus on the small employer market, vesting reform for all retirement plans, simplification that's explicitly linked with improved coverage and non-discrimination requirements.

Finally, we commend the subcommittee for focusing attention on this critically important issue. The implications of inadequate pension coverage and benefit receipt are far-reaching. But they're also directly related to income. We need to address these issues now and take steps that will narrow the gap between those workers who are financially able to save adequately and those who cannot.

Thank you.

[The prepared statement follows:]

Statement of Cindy Hounsell, Executive Director
Women's Institute for a Secure Retirement
Subcommittee on Oversight
Committee on Ways and Means
Hearing on Pension Issues
May 5, 1998

Good afternoon. On behalf of the Women's Institute for a Secure Retirement, I want to thank the members of the Subcommittee and particularly Congresswoman Johnson and Representative Coyne for inviting me to testify today. My name is Cindy Hounsell and I am the Executive Director of WISER, a nonprofit organization, launched in 1996 by the Teresa & H. John Heinz III Foundation.

WISER's primary mission is education -- providing women with information and retirement planning skills so that they can surmount the overwhelming challenges to securing retirement income. Our goals include increasing awareness among the general public, policymakers, and the business community, of the structural barriers that prevent women's adequate participation in the nation's retirement systems.

We applaud this committee for focusing on the status of our nation's pension system, and for allowing us to bring to your attention the ways in which the system's current inadequacies affect working women.

Retirement Challenges for Women Workers:

- Three out of Four working women earn less than $25,000 per year.
- Half of all women work in traditionally female, relatively low paid jobs—without pensions.
- Women are more likely to work in part-time and minimum wage jobs without pensions
- Women's earnings average $.74 for every $1 earned by men.
- Women retirees receive only half the average pension benefits that men receive.
- Women spend fifteen percent of their careers caregiving outside of the workforce compared to less than 2 percent by men.

Reasons Why Women Need More Retirement Income

- Women live longer than men.
- Women earn less than men so their Social Security and pension benefits are smaller .
- Women are likely to be single – and not remarry. Non married women are more likely to be poor.
- Women are more likely to need long term institutional care.

Background

Most Americans, regardless of their gender are ill-prepared for their golden years. The retirement fate that awaits most women however, is by far the most troublesome problem. Of the 63 million baby boomers in America, fully 32 million are saving less than one third of what they will need for retirement – and the overwhelming majority of those who are not prepared are women.

Although the nation's pension system is gender-neutral, it was set up to reward a work pattern that does not reflect the reality of women's working lives. The revolution in women's roles in society over the last generation has not relieved them of their responsibilities as family caregivers. Women are still more likely to leave the workforce or to work part-time to accommodate care-giving responsibilities. In addition to maternity leave, they also bear the primary responsibility for an ill child or a sick relative – resulting in shorter job tenures. For example, women stay in jobs an average of only 3.5 years, whereas pension vesting rules generally require five years on the job.

Women as low-wage earners saving for retirement.

Over the past fifteen years there's been a shifting of the burden of retirement from the employer to the employee -- a trend that will almost certainly have a disproportionate effect on all low wage workers but particularly women for the following reasons.

First, it is important to realize that the majority of women today, are clustered in low and middle income households. The median income for all working women under age 65 in 1996 was $14,476 and for full time women it was $24,899. (See attached income chart) The fact that women earn 74 cents for every dollar earned by men creates less of an opportunity for retirement savings and means that women's pension benefits will be lower than those of men. It also means they have substantially less income available to put in an IRA or a 401(k) savings plan.

Because three out of four working women earn less than $25,000 annually, even a disciplined saver will have trouble accumulating much in savings at that level. Second, studies have shown that women's savings priorities are often focused on their children's education and not on retirement. Third, with women moving in and out of the workforce and from one job to another more frequently than their male counterparts, the problems associated with lack of portability become particularly acute for them. And again, because of priorities such as their children's education and medical emergencies, women often opt to cash out their 401(k) accumulations when they leave a job rather than keep the funds for retirement.

Finally, given the fact that women generally have smaller amounts saved in their 401(k) accounts and have less to fall back on from other sources, it is not surprising that they are often more averse to riskier investments that may provide a higher yield. It is not simply a lack of financial sophistication, it is actually a pretty rational behavior.

Consider the startling statistic that indicates that for those workers over age 40, the average woman has accumulated only $7,000 in her 401(k) savings plan whereas the average man has accumulated $20,000 in his.

The Effect of low wages on pension benefits.

We all know that access to a 401(k) plan is certainly better than no retirement savings vehicle at all – but only if you can afford to contribute to it. We are concerned that pensions have evolved into a benefit for the highly paid. A *USA TODAY* survey of the nation's largest employers found that the worst plans are offered in the retail and service industries, where the workers are less likely to have pensions, the pay is low and the jobs are dominated by women. The survey's result indicated that the workers least able to save have the lowest matching contributions.

And a study published in 1996 by the Social Security Administration found that income distribution in the receipt of pension benefits is highly skewed toward those at the top of the income ladder-- 84 percent of aggregate benefits are disproportionately distributed to those in the top two income groups while those in the bottom two groups were receiving only 4 percent. Another indication of how inequitable the private pension system is for low wage workers.

But most women aren't lucky enough even to have a pension, regardless of its size. The recent corporate legacy of downsizing and economic restructuring has had a disproportionate impact on women. Currently, 40 percent of all women's jobs are now non-standard. These non-standard jobs are part-time, contract, freelance, and often in combination to create one full-time job. But more importantly, these jobs mean low wages, fewer employee benefits and most often no company pension plan.

Women's jobs are low-wage, service, part-time jobs and/in small businesses -- where pension coverage is the most sparse. Although full time working women have made great strides in nearly reaching parity with men, it is partly due to the declining pension coverage for men. When all working women are compared to all working men there's a 7 percent gender gap.

The Effect of Women's longer lives.

Financial experts tell Americans generally to plan to replace 70 or 80 percent of their income at retirement. Unfortunately, this advice doesn't work for women, who are likely to need more than 100 percent of their pre-retirement income in order to remain secure throughout their longer lives.

The higher life expectancy of women necessarily means that at some point during their retirement the vast majority will find themselves alone. In fact, about 80 percent of men die married and 80 percent of women die single. Living alone is another predictor of

elderly poverty and women are much more likely than men to live alone. A single elderly woman is twice as likely as an elderly man to be poor.

Divorced older women As a group, separated and divorced older women have the most serious economic problems. When couples divorce, the wife typically experiences a 26 percent decline in her standard of living compared to a 34 percent increase for their ex-husbands. This translated into women having less money to spend on essentials and even less to save for retirement. Also, many women overlook the fact that they can claim a share of their husband's pension as part of the divorce settlement.

It is also important to note that our nation's poverty rate for single elderly women, which stands at about 18 percent, is by far the highest percentage in the industrialized world. And the breakdown of poverty rates among minority groups is even more stark.

For all of the reasons outlined above, defined contribution plans may not always be the best option for women, who might in fact be better served by the features available in a defined benefit plan –a defined benefit plan has a lot going for it as far as women are concerned, including a guaranteed pay out in monthly installments over the remainder of one's life.

SAFE Plan

In that regard, we are pleased that Congresswoman Nancy Johnson, along with Congressman Earl Pomeroy, has introduced H.R. 1656, the Secure Assets For Employees Plan Act of 1997. The SAFE plan provides a framework to enable smaller employers to offer real pensions to their workers. The bill guarantees a minimum defined benefit, which as I have stated is so critical for women. It also introduces portability to these benefits, so that when an employee leaves her job, she can take her retirement savings with her.

There are also important safeguards written into this bill. It requires that the SAFE plans be fully funded and that the actuarial assumptions be conservative, so that a minimum guaranteed benefit can be achieved. If the plan exceeds conservative expectations, the beneficiary receives higher distributions. Employees will be able to keep track of their assets and their future retirement benefits through an annual account statement. SAFE also ensures that employees' benefits are 100% vested at all times and that all plan participants are treated the same.

This bill is also extremely attractive to small business owners, who are spared much of the administrative burden and complexity associated with traditional qualified retirement plans. SAFE is a much more affordable alternative to these plans, and it is designed to complement the SIMPLE plan, which many small businesses have begun to offer.

We would also like to mention our support for another bill that addresses the problems women face in achieving retirement equity, and that is the Comprehensive

Women's Pension Protection Act -- H.R. 766 and S. 320. This bill was introduced in the Senate by Senator Carol Moseley-Braun and in the House by your colleague from Connecticut, Barbara Kennelly. The Senate version, S.320, has bipartisan support, as Senator Olympia Snowe, is a lead cosponsor of the measure. I hope the members of this subcommittee will take a look at this legislation and consider lending their support to it.

Finally, we commend this Subcommittee for focusing attention on this critically important issue. The implications of inadequate pension coverage and benefit receipt are far-reaching and directly related to income. We need to address these issues now and take steps that will narrow the gap between those retirees who are financially able to save adequately and those who are poor.

Thank you.

WISER

WOMEN'S INSTITUTE FOR A SECURE RETIREMENT

All Women with Income in 1996

- **Nearly 3/4ths of women earn less than $25,000**
- **1.7 % earn $75,000 and over**
- **4% earn $50,000 to $74,999**
- **8.8% earn $35,000 to $49,999**
- **13% earn $25,000 to $34,999**
- **21% earn $15,000 to $24,999**
- **13% earn $10,000 to $14,999**

Full time workers

- **3% earn $75,000 and over**
- **8% earn $50,000 to $74,999**
- **15.9% earn $35,000 to 49,999**
- **22.7 earn $25,000 to 34,999**
- **31% earn $15,000 to 24,999**

Median income of all full time women under age 65 is:	**All Women Workers**
$24,899.	**$14,476.**
age 25-34 is $23,838	**$16,384**
age 35-44 is $26,787	**$18,447**
age 45-54 is $27,154	**$19,046**
age 55-64 is $25,080	**$13,316**

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Chairman JOHNSON of Connecticut. Thank you.

Ms. Patterson.

STATEMENT OF MARTHA PRIDDY PATTERSON, DIRECTOR, EMPLOYEE BENEFITS, POLICY AND ANALYSIS, KPMG, COMPENSATION AND BENEFITS PRACTICE, PEAT MARWICK, LLP

Ms. PATTERSON. I'm Martha Priddy Patterson with KPMG. I think I'm here as a sort of a bridge witness in the sense that in the day time I work with employers on these various difficult retirement plan issues. That's my vocation. My advocation has been talking to groups of women in two or more wherever they will gather about the importance of starting early to plan for their retirement and planning forward.

Ms. Hounsell and I are sort of the "Thelma and Louise" of retirement planning for women in that we will go anywhere, anytime to talk with women about how important it is to address these issues. However, we frequently come at these things from different sides, just like Thelma and Louise.

I liked much of what I read in the bill this morning. I must tell you I spend a great deal of time reading through legislation and this was the first bill that I looked at in a long time that made me smile. There're some wonderful things in there, and let me skip right to the one that does help, I think, a little bit with the very low wage earner woman and that is eliminating the 25 percent of compensation limit. That just punishes low wage workers, male or female. And it also robs them, too often, of matching contributions from their employer. Our survey that we do each year for retirement plans shows that about 85 percent of people who are in 401(k)'s get a match. When you're cut off from putting in more than 25 percent of your income that is a big problem, and that's a problem not only for women but for their families. Recognize that over 50 percent, or nearly 50 percent of people in this country have access to no pension, private pension plan at all. So when you've got a two wage earner family, as most of our families are today, of course, it's likely that one of them is not getting a pension at all. If the other one is, it becomes even more important that they not have limits on their income to set their wage bases and to set their retirement benefits at those very low wages.

So I thought that was a very good thing. I also liked the idea of the catch-up provision. I don't disagree with Cindy that does not really help people at the lower end of the wage scale, there's no question about that. But I do think it's very, very important for those at the middle levels. If there are problems with the non-discrimination rules on the catch-up, and I think there very well may could be, there's an easy answer to that and that is you simply exempt them from both the 401(k) non-discrimination rules and from the 401(a)(4) rules and simply require that the individual first fund up under the regular contributions before they get to that catch-up provision. So I think that that's an issue that can easily be worked on.

I want to touch on something that no one else here today has talked about so far and that is the treatment of ESOP dividends. I cannot understand, I have never understood the rationale and justification for giving the employer deductions for the dividends

that are paid out of that ESOP, the only retirement plan that lets us get earnings out of it, by the way. And, indeed, encourages employers to get the earnings out of there. And does not give a deduction to the employer, if those dividends remain in the ESOP. That—I just do not see the rationale for that at all.

And I want to skip right on with the length of time that we've got, and, you know, my testimony will be made part of the record, to address a question that the Chair posed about the overlapping limits and the lack of necessity for them. And you asked is there any way to rationalize these? Of course, there isn't. Let's be frank and real about this. The reason so many of those limits go there, and it's not just a belt and suspenders, it's a unitard over long underwear and belt and suspenders. We've got so many limits, and the reason they got there was we needed the revenue and we knew that. And many of these things were adopted, not because they had any pension policy whatsoever, but because we simply needed the revenue.

With that, I see my time is running out and I'll conclude my remarks.

[The prepared statement follows:]

KPMG Peat Marwick LLP

Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives

Oversight of Pension Issues
Chaired by Congresswoman Nancy L. Johnson
May 5, 1998

Special Issues Facing Women and Other Short-Tenure Workers

Testimony of
Martha Priddy Patterson,
Director Employee Benefits Policy and Analysis
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Chairman Johnson's hearings to explore the need to "prune" pension law in order to strengthen the private pension system and to reduce the limiting effect pension laws have on women's ability to build security retirement savings are good news for everyone -- employers, retirement plan sponsors and administrators, families and working women and men. Certain complexity in pension law is inevitable. It is a difficult intersection of taxation, fiduciary duty and actuarial science. And this inherent complexity makes it all the more important that needless complexity be avoided. I commend the Chair and the Subcommittee for addressing this unglamorous, but critical area.

For too long, pension laws have been built layer upon layer, all too frequently with changes adopted as much to provide "pay fors" for the revenue estimators as to protect employees' retirement benefits. It is clear to all that a comprehensive review of the effect of these intricate and duplicative rules on retirement plans, employers and employees is long overdue. The need for review and rationalization of the effect of overly complex pension law on the workforce, Social Security and national savings policy, while less obvious, is equally important.

Background and Experience with Retirement Plan Compliance

I work in KPMG's Compensation & Benefits Practice and for the last six years have been responsible for KPMG's annual retirement benefit survey among employers of 200 or more employees, *Retirement Benefits in the 1990s.* ERISA was the first piece of legislation I reviewed, when fresh from law school, I went to work for Congressman Bob Eckhardt of Texas. It was a massive and comprehensive law then in the summer of 1974. The more than 20 significant laws amending ERISA since then have only added to its complexity. My views on these issues are shaped by the more than 17 years I have worked directly with retirement plan sponsors to help them design and communicate effective retirement plans -- and to help plan sponsors operate the plans in compliance with the ever-changing law. That has been my vocation.

My avocation has become talking with women any time and any place about the importance of retirement saving and investing both through their employers' plans and through their own personal savings. And I surmise the Subcommittee invited me to appear today as much because of my avocation, as much as because of my vocation. Through both my role at KPMG and through these "volunteer" conversations with individual women and women's groups, I became convinced that too many individuals are confused and frustrated in their attempts to begin saving in employer retirement plans and in IRAs or to maximize those plans fully when they do begin saving.

With the move to add defined contribution plans, which generally require some participation and action on the part of employees and which place the risk of investment on employees, this confusion can make a critical difference in the employee's ability to use employer retirement plans to the fullest in saving for retirement and preserving those savings during retirement. Because I heard the same questions repeatedly, I finally wrote *The Working Woman's Guide to Retirement Planning* to help women understand how employer plans work and how those plans, Social Security and individual savings form essential links for a security retirement.

Women's Special Career Patterns and Lower Wages

Retirement plan law and principles are gender neutral. Plan sponsors certainly do not discriminate in the offering of retirement plan benefits. But, in fact, typical women's career patterns have the result of dramatically reducing employer-provided benefits, as they would do for a man with the same career pattern. Employers and policy makers are coming to realize what many of us have known for a long time. Today's career patterns may not result in adequate retirement savings even when the employer attempts to provide the best possible retirement plan.

Additionally, in analyzing the effects of pension changes on women, we have at least three distinct cohorts of women for whom various proposals may have different effects. First, women toward the end of their careers entered the work force at a time when paying women for lower wages for the same work was legally permissible, and sometimes encouraged. Also, for much of that time the law permitted employers to require ten years of continuous service for vesting in retirement benefits. The second cohort consists of those women who entered the workforce in the 1970s, significantly and, apparently permanently, increasing the percentage of women in the workforce. These women were among the first to have legal protections regarding pay and equal access to advancement. (Although the significant gap in pay suggests these protections were not perfect.) Finally, the women just entering the workforce are in a third cohort that will find employer-provided retirement benefits increasingly based on amounts contributed at least in part by the employee and in which more investment risk is increasingly shifting to the employee. For this group, Social Security retirement benefits almost certainly will be different than those expected by earlier generations and may also place at least some of the risk of investment on the employee.

Women have special circumstances in planning for retirement.

- They live longer than men and consequently will need more money in total.
- They have slightly lower job tenure with women over 25 having on average 4.7 years with an employer and men having 5.3 years, according to Bureau of Labor Statistics data for 1996. Because vesting is based on five year tenure, this slight difference can be critical in earning retirement benefits.
- Women are more likely to take time out of the workforce for care-giving duties, losing retirement benefit accruals for those years.
- Women working full time, year round still earn on average less than 80 percent of men earn. This has a double hit. Lower earnings make it harder to save for retirement, or anything else.
- More important lower wages mean significantly lower retirement benefits, because those benefits are based on salary. The same retirement plan on average will provide a lower benefit for women than for men because of this pay differential. Additionally, because of the way pension benefits accrue, the difference in wages results in an even greater difference in the retirement benefit eventually received.

In *The Working Woman's Guide* I built on work I had done earlier for the Bureau of National Affairs, Inc. and for the American Association of Retired Persons on retirement plan benefit accruals under typical women's career patterns. Using actuarial calculations and scenarios of different work patterns among women with different family circumstances, I illustrated how a job change or even a few years out the workforce could dramatically affect retirement benefits. For example, a woman who changed jobs six times over a career spanning 42 years and who took three one-year breaks during that 42 year career would have a final pension of just over one-third the amount she would have received had she stayed in one job. Most of those losses were due to failure to vest and changing jobs. With the reduction of the maximum vesting period from 10 years to five years for years after 1989, some of the loss for women entering the workforce after that time will be cured. But for women who entered the workforce prior to that time, the benefits are lost forever. What a difference it would have made to have catch-up contributions available in these situations. What a difference these contributions may make still!

The following table shows a vivid example of the current population difference among women who are receiving retirement benefits based on their own wages (not as survivors) and makes an eloquent argument for measures that will help close this gap.

This gap is critical, not just for women, but for families and for society. For the last two decades, we have become a nation of dual wage earners. What will it mean for families, for our nation's economy and for the Social Security system, if at retirement families that have always lived on two incomes suddenly find themselves living on only one source of retirement benefits or -- at best on the one-and-a-half sources of benefits, as shown in the table?

Average Annual Pension Benefit

	Men	**Women**
Total	$ 11,784	$ 5,230
Year of Initial Benefit Receipt		
Prior to 1975	6,808	3,092
1975 - 1979	9,992	2,896
1980 - 1984	9,337	4,824
1985 - 1989	11,478	5,528
1990 - 1992	16,350	6,584
1993 - 1994	15,568	6,820
Don't know or no response	9,603	1,108

Source: Retiree Pension and Health Benefits Supplement to the September 1994 Current Population Survey.

Recent proposed legislation, including a bill just introduced by Congressman Portman (R-OH) and Congressman Cardin (D-MD), offer a number of good ideas to begin to address these problems.

Eliminating Percentage of Salary Cap on Pension Contributions

Under current law (IRC section 415(c)) annual additions to defined contribution plans for any individual employee may not exceed $30,000 or 25 percent of the individual's pay, whichever is less. Included in these amounts are amounts contributed or deferred by employees as well as amounts contributed by the employer. Numerous proposals, including the recently introduced bill by Congressman Portman (R-OH) and Congressman Cardin (D-MD), would retain the $30,000 limit (which will eventually be adjusted for inflation), but eliminate the 25 percent of compensation limit.

Given numerous other limits on employee elective deferrals, and the absolute dollar limit on annual contributions to defined contribution plans, the 25 percent of compensation is not necessary to avoid excessive tax-sheltering. The limit simply punishes the thrifty, low-paid employee and the plan sponsor. Eliminating the percentage of compensation limit will give employees greater ability to increase their retirement savings. The limit is redundant. These multiple limits complicate plan administration, are confusing to employers and employees alike, and reduce benefit security by forcing more and more employees to rely on unfunded arrangements for growing portions of their retirement security.

The elimination of the 25 percent of pay limit would provide significant simplification for plans and, more important, provide significant opportunities for lower paid employees to increase their retirement savings. Over 90 percent of the time, when KPMG finds employee deferrals in excess of these so-called "415 limits," the employees who have "over" contributed are lower paid employees. For example, while this year's limit on 401(k) contributions is $10,000, only those individuals earning over $40,000 can actually contribute that amount without violating the 25 percent of pay limit. Being unable to contribute more of her own money to the plan means the employee almost always loses additional retirement savings she would have received from an employer matching plan. (According to KPMG's *Retirement Benefits in the 1990s: 1997 Survey Data,* 85 percent of 401(k) plan participants have an employer matching contribution.) Frequently, these individuals are from two-earner families in which the other earner does not have an employer-provided retirement plan, so this plan may be the only source of employer-subsidized retirement savings available to the family.

The elimination of the cap would also greatly simplify calculations which must be done to determine reach the cap. While "25 percent of compensation" seems straight-forward enough at first, numerous questions arise. Is overtime included, are bonuses included, is taxable in-kind compensation, such as certain employer-provided housing or education included? The regulations address these issues and the plan may also address certain of the questions, but the answers may require consulting with an ERISA specialist. By contrast, the $30,000 limit is clear and easy to apply.

The elimination of the 25 percent cap would also make it possible for many families to make de-facto catch-up contributions, by adding more to their plans in certain in years than the might ordinarily be able to make on annual basis.

Catch-Up Contributions

Under current law, various statutory limits in effect prohibit employers from permitting contributions or deferrals to their retirement plans for any period for which the employee was not earning compensation from the employer. Various proposals, including the recently introduced bill by Congressman Portman (R-OH) and Congressman Cardin (D-MD), would expand these limits to allow "catch-up contributions" for years in which employees were out of the workforce or were not offered retirement plans by other employers. These proposals will help all individuals saving for retirement, but the concept is particularly helpful to both women and men in balancing family responsibilities. Because only about 50 percent of workers are offered an employer-provided retirement plan, catch-up contributions could be extremely important in helping employees make up for the time they worked for employers without a retirement plan and could only save for retirement on a tax-favored basis through an IRA.

For the maximum effectiveness, any catch-up contribution proposal should place minimal burdens on the employer offering the catch-up plan. No required matching of catch-up contributions should be required, although certainly such matching should be encouraged. The employer sponsoring the plan should be bear the burden of certifying the employee's eligibility for catch-up contributions. For maximum effectiveness, the eligibility for catch-up contributions should be fairly broad.

Same Desk Rule

Under current law, 401(k) plan distributions can be made when an employee "separates from service." The phrase "separation from service" has been interpreted to by the courts and the IRS to embrace what is known as the "same desk" rule. Under that rule, an employee is deemed not to separate from service when, as a result of the sale of the business, the employee transfers from the seller to the buyer, but continues to perform substantially the same duties as those that the employee performed before the sale. Because of this rule, the employee who transfers from a seller to a buyer might not be eligible to receive a distribution from the seller's 401(k) plan until the employee separates from service with the buyer. The practical result is that the former employer, who may wish to cease business operations entirely, will not be able to terminate the retirement plan, after the sale. The employee will have divided retirement plan amounts, including some amounts in a plan whose sponsor no longer exists as an active entity. Once the employee retires and wants to begin the distribution from the old plan, the employee may have difficulty finding the plan and the plan may have difficulty keeping track of the employee.

There is no rational basis for such complicated rules for distributions from 401(k) plans. The IRS has permitted other pension plan distributions in same desk situations. Generally, plans may make distributions when the employee leaves employment and there is no valid reason not to interpret the sale of the employer as leaving employment and hence permitting the distribution of 401(k) plan assets. The "separation of service" standard raises many issues when the company is sold and the employee has technically severed employment with that employer, but continues to work at the same place and in the same job for the new owner. This proposed change clarifies

that in such a circumstance the old employer can distribute 401(k) benefits to the former employee. The current law also impairs the portability of 401(k) plan benefits and makes buyers reluctant to allow their plans to accept direct transfers from the sellers' plans. Rationalizing these rules will make it easier for employees to roll over distributions from sellers' plans to buyers' plans.

ESOP Dividend Distributions

Under current law, dividends paid on ESOP stock are deductible to the plan sponsor if distributed and paid in cash to the plan participants or beneficiaries either directly or through the plan or if the dividends are used to pay off the ESOP loan. The employer may not deduct such dividends if ESOP participants and beneficiaries are permitted to reinvest the dividends in the ESOP.

There appears to be no rational basis for denying a deduction for dividends reinvested in the ESOP. Indeed, the provision seems to be directly contrary to nearly all other provisions of retirement law, which emphatically require that earnings of a retirement plan be retained in that plan until the participant retires. No plan participant -- including ESOP participants -- should be encouraged to receive earnings from the plan prior to retirement.

The loss of a deduction for dividends retained in the ESOP acts as a disincentive for employers. ESOP participants should be able to reinvest dividends and acquire more shares of stock and earnings within the ESOP without costing the employer the loss of a deduction.

Tension Between the Voluntary Retirement Plan System and Pension Protection

Pension simplification is critical because of the voluntary nature of the employer-provided retirement system we have. I am not crying "wolf" here. Pension complexity has not -- and probably will not -- cause a massive employer exit from the retirement plan market.

But pension complexity has insidious effects nevertheless. First, valuable dollars that could go directly to increase compensation to employees through retirement plans or other compensation are instead used for plan compliance and redesign. Second, employers who do not currently offer retirement plans have less incentive to enter what they regard as a complex and overregulated area of compensation. Laws to "encourage" the expansion of pensions through special plans for small employers are enacted with the effect of further complicating the pension system and employers' perceptions of that system. Third, employees are confused by the myriad of rules applying to their plans. As a result, some employees become too daunted by the details to participate in the plans. Other employees make costly mistakes in contributing too little or investing too conservatively. Some employees make costly mistakes in attempting to transfer their benefits from one plan to another or in distributions at retirement.

A little simplification could benefit employers, employees, regulators and the Congress.

Chairman JOHNSON of Connecticut. Thank you very much. That was a very important point that you made about the two earners. With so many employers not offering a pension plan at all, the limit is very harsh because it doesn't allow a couple to make the decision to have one salary to try to provide their retirement benefits while the other's salary provides their income.

And then your explanation of why we have these overlapping requirements is an honest one. I think one of the reasons I want to encourage you all to think out of the box is that, you know, if revenue is problem, then we think about how to phase in. But if you phase in a simple reform, you get to the right place in the end. If you just don't reform because of the revenue implications, you never fix the problem. So I think we ought to not let the revenue implications prevent us from thinking about what will it really take to get more people into a savings system to assure that they will have greater retirement security than is possible under the current plan.

And I think, Ms. Hounsell, your data and Mr. Lewis' data about where many women are now and where they're likely to go without change is startling. And if there was ever a case to be made for thinking outside the box, that case can be made right now. And then we will deal with the issue of revenue, but if we don't look at what would be the reform that will serve people, then we won't have done our job.

So, thank you very much for your testimony. Mr. Coyne?

Mr. COYNE. Thank you, Madam Chairwoman. I'd just like to ask Mr. Lewis, given the breadth and the somewhat disturbing results of the survey, where do you intend to take your efforts after this?

Mr. LEWIS. Well there's three pieces to that. The first piece is we are in the process of preparing another national poll that looks specifically at Asian Americans. I know Mr. Salisbury's group has looked at that, it's probably in a much more smaller context but we're working on a national poll because in terms of population groups, no one has really looked effectively at Asian Americans to understand what they are and are not doing as well. We hope to be in the field in the next couple of months on that.

The second thing that we're doing is we have initiated, through the Women's Institute, a series of minority initiatives. In Georgia, in Pennsylvania, and elsewhere across the country, designing strategies at the grassroots level working with African American and Hispanic American groups that are designed to bring educational initiatives in multiple languages to them, but to work with grassroots leaders to open doors before we can get to other people in the community. But to educate them first, educate those who are grassroots leaders who can go out, who they can go out and educate others.

And the third piece that we're doing is really then focused on the whole issue of divorce. Divorce becomes a major issue with regard to pension issues. You know, when we did the Retirement Equity Act in 1984, and we passed the QDRO, you know, when we did the QDRO, the Qualified Domestic Relations Orders, it was a major step forward. But we have a population of women today who are what we refer to as the "forgotten faces," whose husbands got them to sign a waiver and who took a lifetime benefit adjoined survivor

annuity, and had really no understanding what they were signing, pre-QDRO and post-QDRO. And then the QDRO problem is then compounded by the fact that, you know, when a woman goes into a divorce setting, she is often with a lawyer, who in many cases simply doesn't understand the law, doesn't understand what a Qualified Domestic Relations Order is, doesn't know what kind of questions to ask of the husband, or the husband's attorney, and many times she will, you know, take a house as a defined benefit in lieu of a pension. And while it may be a valuable asset now, in the long term she is giving away significant financial security.

Cindy and I are now graphing a piece we hope to go to a magazine very soon on the whole issues of divorce. We did a piece, as you are probably aware of, for Good Housekeeping that was published in April of this year. So our goal is then for next year to do a piece separately on divorce. Each of the pieces that we do then are published in English, Spanish, Portuguese, and at least one Asian dialect.

Mr. COYNE. In your testimony, you mentioned efforts by the foundation to develop a national pension plan, could you tell us anything more about that?

Mr. JEFFREY LEWIS. Congressman Portman has the provisions bill that he spoke about earlier about allowing small businesses to simply allow—not have to contribute but allow people to save some form of income which is a tremendous effort. But in the event that that doesn't happen, we've been working on an effort to try and figure out how you establish a national pension plan, recognizing that small businesses can only do so much. And in they're trying to maximize their ability to remain competitive in the workplace, either domestically or globally, we're looking at a program to try and find out how do we get workers to begin to save money, minimizing to the extent possible, what the overhead expenses would be for a small employer and simply taking the deduction out and shipping it someplace else where the funds would be managed. We've been in conversations and discussions with Morgan Stanley and a number of other people in putting such a plan together.

Mr. COYNE. Thank you. Ms. Hounsell, how much of the women's retirement savings crisis would you attribute to the lack of knowledge about how and why to save for retirement, and how much is simply driven by the lack of money to put aside?

Ms. HOUNSELL. Well, I think, it's basically the lack of funding although Martha Patterson and I always have this same conversation that is that everyone can save even a little bit, and clearly that's the education piece that people need to hear. But, what people really need is a pension or some way to save through their employer and that just doesn't exist for the majority of working women.

Mr. COYNE. So it's your sense that it's probably more tipped towards the fact that people don't have the money to put aside?

Ms. HOUNSELL. Right. I mean, they can't find it at the end of the day. If there were a small amount that could be taken out of their gross pay, say 1 percent and put in an employer vehicle, it would likely spur people to do just that. But if they don't have that opportunity at work and they don't have the employer pushing a plan—I've heard so many stories from people where women say, "You

know, I never would even have started doing this if it weren't for somebody in my office who told me I had to do it. Even though I couldn't afford it, they made me do it and that's the only reason I have anything today."

Mr. COYNE. Thank you very much.

Chairman JOHNSON of Connecticut. I think that's a very good point. It's like Social Security is taken out, FICA taxes, and you never see it so you never know it. And I think we need to be able to have that option at a low enough level so that even if you are counting every penny, you can learn to count a few less. Mr. Portman?

Mr. PORTMAN. Thank you, Madam Chair, and thank you all for your input. Ms. Patterson, I really enjoyed your analysis of why we have these various rules, boot straps and suspenders, and other things. And I think you're right in regard to some of them. Some of them you can look at specifically and see that it was for a revenue raiser. Others, the top heavy rules, for instance, came about, I think as well intentioned but perhaps weren't meant to be part of a larger layered approach, and in the aggregate, I think, are now having a negative impact.

Just briefly, on the ESOP provision, you analyzed it, I think, perfectly but you didn't say whether you thought it was good or bad in the legislation. I think what you're saying is you think that so long as the employee is making the reinvestment into the ESOP that there ought to be a deduction so that it encourages retirement savings through the ESOP, is that correct? You would support the provision in the legislation?

Ms. PATTERSON. Yes, that's correct.

Mr. PORTMAN. Okay.

Ms. PATTERSON. If I left any confusion about that, I regret it. If I can just add one little thing to the QDRO's, let me tell you that's something that drives plan sponsors crazy too.

Mr. PORTMAN. Sure.

Ms. PATTERSON. So, we really need to try to find some ways to get that problem cleaned up. It also drives lawyers crazy, divorce lawyers, because they don't, they don't know what to do with it.

Mr. PORTMAN. Yes. One other quick question I would have on the 25 percent rule we're repealing, I think you're exactly right. I was trying to get at that earlier but it only hurts, as one of our earlier witnesses said, rank and file folks. In other words, if you're a highly compensated person, the 25 percent rule is not going to be your cap. It's going to be the contribution limit.

Ms. PATTERSON. Exactly.

Mr. PORTMAN. And so I appreciate the fact that you support that repeal and I think it will help lower paid women and lower paid men as compared to highly compensated.

The catch-up issue, you know, is going to help and so on and your thoughts on exempting it from the non-discrimination and top heavy rules, I think that's something we need to look at it. Who it helps really goes to the bigger issue, which Ms. Hounsell talked about earlier, and whether folks are going to save who are at the lower income levels. And the other way to go about this, of course, is for the Government to provide on the direct expenditure side more income, either through Social Security, which is already a

program which is progressive or through some other direct means and I guess what we're saying here is we don't see that happening, particularly given the state of Social Security so we need to provide that expansion. As Ms. Hounsell said earlier, some of these women are in jobs where there just isn't an opportunity. I mean, some of them will not save any way because they need every last cent for the daily needs. But in other cases, there's not the opportunity among small employers, defined as 25 or fewer. We understand that fewer than 30 percent offer any kind of retirement savings plan at all now.

And we're going to hear from the Chamber, I saw their testimony a second ago that there are roughly 30,000 employers who have now adopted the SIMPLE plan which, if you assume it's on average 10 employees, that's 300,000 workers who are now covered. And as Mr. Lewis says, it's just not the workers it's usually the family because of the lack of coverage. So, often there's just one spouse. You mentioned earlier your support for the defined benefit plan, the SAFE type plan, do you think providing more incentives in terms of SIMPLE, SAFE, this contribution we talked about earlier outside of a plan, will actually begin to get at some of the problems that you identified?

Ms. HOUNSELL. Yes, I have changed my position over the last 10 years. I believe any vehicle is helpful even the salary reduction SEP which was eliminated from the law when the SIMPLE was instituted. I've heard complaints from so many people about that elimination because that was all they had and so any vehicle, I think, will make a difference.

Mr. PORTMAN. Yes.

Ms. HOUNSELL. Because it gets people started. I believe small employers especially need a good starter plan.

Mr. PORTMAN. Any thoughts on that Mr. Lewis?

Mr. JEFFREY LEWIS. No, I mean, we know from the polling data that any knowledge of savings is a major factor in a woman's ability to save. The more she knows the more likelihood that she is to save, and it's particularly true among minority women.

Mr. PORTMAN. One thing I do and I'm sure Mrs. Johnson and others do, is to go to high schools and talk to kids about saving in 401(k)'s and profit-sharing plans and so on and you get kind of this stare, like, I'm going to live forever and I'm not going to need it. I mean, it's very difficult but I think there's an obligation on all of our parts to begin to develop that sense that it is, in fact, one of the best deals out there. If you have it through your employer, take advantage of it. That word gets out.

Mr. JEFFREY LEWIS. One of the things, if I could comment, one of the things that Cindy and I have done as we travel across the country is do a little chart showing compounding so if you, when you say to an 18-year-old, because we talk to them as well, if you can take $100 a year, or a $100 a month, whatever the amount of the money is, let us show you what it looks like, assuming 8 percent or some percentage, and their eyes open very wide.

Mr. PORTMAN. The power of compound interest.

Mr. JEFFREY LEWIS. The power of compounding really educates them because they begin to understand what that means in terms

of just general savings or in terms of an Individual Retirement Account. That really does help.

Mr. PORTMAN. Good luck.

Mr. JEFFREY LEWIS. Thank you.

Ms. HOUNSELL. Thank you.

Chairman JOHNSON of Connecticut. Congresswoman Thurman?

Mrs. THURMAN. Thank you, Madam Chairman, and I apologize, I have constituents in; it happens, it's a part of this job. The ESOP issue has been a big issue for me. I have some employer owned businesses in the district and, in fact, am part of the legislation that would try to look at the issue that's being discussed here. In the conversation, though, with this panel, do you see that as maybe a possible benefit for the women that are working since they would actually be able to reinvest which would also bring up their retirement plans to a better level, fortunately, than others?

Ms. PATTERSON. Certainly the idea that the dividends that can be kept in the plan and the employer still get the deduction is a benefit for everyone in the plan. I don't think there's any question about that. I don't think it has a major effect between genders, frankly.

Mrs. THURMAN. Okay. In the last panel, and if I missed this, I apologize, and I know that Portman talked a little bit about this but in this idea of the highly compensated and their making the decisions for their companies whether or not to have a pension plan or not to have a pension plan. Have you, did you look at that in any of your studies as to that being a real cause out there? Is that really a cause? Do they really make those decisions based on that? Is that causing some of this problem?

Ms. PATTERSON. I think there are a number of different levels of employers. Major employers who are offering benefits are offering benefits because they want to offer benefits. The limit on various compensation levels or benefit levels, their executives know that they'll just simply, as one of the panelists said, they'll get what they want and if the company has to gross them up for it, so much the better. So they're not going to not have benefit plans because of these limits. I think on that group of employers, though, that are not currently offering benefit plans, there's very little incentive for the top executives to push to institute a retirement plan when he or she will get relatively little out of it. I don't think there's any question about that so we've got to make those a little more attractive in one way or the other. Either less complex, or more incentives to begin those plans.

Mrs. THURMAN. Now with unemployment being at a low time, we're really at a low point and people are out there in the marketplace. While I can understand what they've said in the incentive part of it, but at the other end of it, in fact, some of these folks' salaries at the top end are based on their production and how much their companies are growing and those kinds of things and part of that is productivity by their employees which would mean that the more benefits they receive, the better feeling that they have that they're a part of what's going on in that company. At what point, as this unemployment stays at this, will we see more and more of decisions being made by companies to add pensions to keep employees because it's a long-term advantage of not having to

do re-training and those kinds of things? Is there any advantage to that at all?

Ms. HOUNSELL. Well, I think there is but I think we have to start educating employees because a lot of employees just are not aware that they really need a pension plan.

Mrs. THURMAN. But if they're being taken away from that job and brought over to another job, one of the reasons they're leaving the job they're in today is because there are plans available. I mean, is that happening out there at all?

Ms. PATTERSON. I don't think that there's any question that a good retirement plan is a great incentive to lure people to the company, and yes, we do find that. But I don't get the sense, and our surveys don't really reflect, that people are instituting retirement plans to pull in people.

Mrs. THURMAN. Okay.

Ms. PATTERSON. Now, they may be. I just haven't seen any hard data on that.

Mrs. THURMAN. I'm just kind of curious. It would be one of the things that I would offer, I mean, if I were trying to get good-trained people, wanting them to stay longer, and I thought that my salary was going to be increased because I had better productivity, you want to make your employees happier, stay longer, and do those kinds of things. I just wondered if there was anything going on out there now with unemployment being so low. It might be an interesting question?

Ms. PATTERSON. I think it will be and I tend it to put in next year's survey.

Mrs. THURMAN. Good, thanks.

Chairman JOHNSON of Connecticut. Thank you very much. I appreciate it Ms. Patterson. There are several bills on the ESOP issue, including one by Cass Ballenger and myself so the provisions are close. Thank you. That's all, right. Thank you.

The next panel, we will have to move right through the testimony so that we get to at least hear everyone before the bells go off. So, if Carlos Saladrigas could start, following by Timothy Doherty, Arthur Caple, David Wray, Lynn Franzoi, and Russ Hawkins, and Howard Weizmann, I would appreciate it. Mr. Saladrigas, chairman and chief executive officer of Vincam Human Resources on behalf of the National Association of Professional Employer Organizations, and the National Association of Temporary and Staffing Services.

STATEMENT OF CARLOS A. SALADRIGAS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, VINCAM HUMAN RESOURCES; ACCOMPANIED BY TIMOTHY E. DOHERTY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, DOHERTY EMPLOYMENT GROUP, ON BEHALF OF THE NATIONAL ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS, AND NATIONAL ASSOCIATION OF TEMPORARY AND STAFFING SERVICES

Mr. SALADRIGAS. Good afternoon, Madam Chairwoman.

Chairman JOHNSON of Connecticut. You're accompanied by Timothy Doherty? Okay.

Mr. SALADRIGAS. And members of the subcommittee, my name is Carlos Saladrigas. I'm chairman and CEO of the Vincam Group, a professional employer organization (PEO) headquartered in Coral Gables, Florida. I am the past president and board member of the National Association of Professional Employer Organizations (NAPEO).

My company is one of the leading PEO's in the Nation, the sixth largest Hispanic-owned company in the Nation, and we have an office in your great State of Connecticut.

With me is Tim Doherty, CEO of the Doherty Group, Employment Group, headquartered in Edina, Minnesota. Mr. Doherty is the immediate past president of the National Association of Temporary and Staffing Services, and is a current member of their board.

We're testifying today in support of House bill 1891, the Staffing Firm Worker Benefit Act of 1997. The provisions of this bill are also included in the pension reform legislation introduced by Mr. Portman and Mr. Cardin.

Today, an estimated 4 million workers are employed through staffing arrangements in the U.S. Staffing firms are playing an extraordinary role in today's economy by providing these workers with increased independence, flexibility, and the opportunity to obtain better pensions and health benefits. It is well known that most of the new jobs being created in the United States today are being created by small businesses. Fifty-three percent of all U.S. workers are employed by small to medium sized businesses, that's a total of over 49 million individuals.

Companies like mine, and Mr. Doherty's, are transforming the way these small businesses respond to the myriad employer responsibilities and risks imposed on them, and by pooling employees of many small businesses, PEO's create a scale and scope that makes it possible for us to deliver affordable, quality health and pension benefits to small businesses.

You see, small businesses today are simply having a very hard time managing the complexities of employing people. These include the responsibility for paying employees, record keeping, providing and managing employee benefits, managing workplace safety, OSHA regulations, workers' compensation claims and last, but not least, the responsibility for compliance with labor and employment laws which, as you know, have multiplied over the last 30 years.

We, in the industry, saw these needs in the marketplace. In response, we created the concept of professional employer organizations, or PEO's, to help take over these employer responsibilities from small businesses and to provide significant retirement and other benefits to workers on a more cost-effective manner. By assuming legal responsibility for these employer obligations, PEO's help to free up small firms from the business of employment so that they can focus on their real business, whether it is a small florist shop, a plumbing firm, an architect's office, or a manufacturer.

As employers, PEO's are responsible for payroll and related payroll tax administration, benefits, retirement plans, workers' compensation. They implement client employment law compliance programs and work on safety policies which have substantially re-

duced workplace injuries and costs. In my firm, we have documented a better than 50 percent reduction in workplace injuries.

Because we operate as large employers, PEO's also bring millions of workers under the protection of Federal laws, such as COBRA, and the Family and Medical Leave Act, and bring millions of employees to the same level of statutory protection that their counterparts enjoy working for larger organizations.

Many of these same benefits are provided by temporary staffing firms, Madam Chairwoman. Temporary help service companies help businesses operate more productively by supplying skilled employees, as needed, to meet seasonal workloads, variable production schedules, and special projects. But temporary work also serves millions of employees who need job flexibility, supplemental income, skills training, and a bridge to permanent employment. In 1997 alone, over 7 million temporary employees found permanent work, 2.9 million as a direct result of their temporary job. As you know, many people prefer temporary work, parents with young children, students needing summer employment, retirees looking for extra income and to stay active, as well as many skilled and highly paid professional and technical workers.

The Government also benefits from the staffing services provided by temporary help service companies and PEO's. These staffing firms operate as large employers with sophisticated automated payroll systems so that we can ensure faster and more reliable payment to the Government of billions of dollars of employment taxes each year. Moreover, by providing workers with retirement plans and other benefits, we provide a secure future for millions of Americans. For these workers, Social Security can serve its intended purpose, which is, to supplement private savings.

Madam Chairwoman, the Staffing Firm Worker Benefits Act is essential in order for staffing firms to continue the positive role that they're playing in the economy. To deliver the services and benefits we provide for employees and customers, we need to bring the tax rules into the 21st Century by codifying the employer status of a staffing firm for employment tax and benefit plan purposes.

Under the Internal Revenue Code, the determination of who is the employer is generally made by reference to the rules historically developed under common law. These rules are outdated. They do not take into account the nuances of our type of service because they focus primarily on who directs the day-to-day work activities of the employee. As a result, our employer status and the validity of our benefit plans under the tax code is uncertain. Under present rules, our ability to sponsor benefit and pension plans is unclear. H.R. 1891 solves this problem by providing that staffing firms that meet the fundamental requirements of an employer, will be treated as the employer for employment tax and benefit purposes, even if they do not direct the worker's day-to-day activities.

Madam Chairwoman, without this bill the health and retirement benefits of thousands of workers could be jeopardized. Many also could lose their protection under Federal law, such as COBRA and the Family and Medical Leave Act, because those laws accent most small businesses. Clarifying that staffing firms are the employer would ensure that workers will continue to get these benefits. It

would also encourage the expansion of benefits, especially to employees working at small businesses.

I would emphasize, Madam Chairwoman, because some have expressed concern about it, that under the bill, protection under Federal and State labor unemployment laws, including civil rights, wage an hour, occupational safety, and collective bargaining remain the same.

Chairman JOHNSON of Connecticut. Mr. Saladrigas.

Mr. SALADRIGAS. Yes?

Chairman JOHNSON of Connecticut. I'm going to have to ask you to suspend——

Mr. SALADRIGAS. Sure.

Chairman JOHNSON of Connecticut. Because we have now 15 minutes, at any rate, we really must move on so everybody will get a chance.

Mr. SALADRIGAS. Sure, all right. Thank you.

[The prepared statement follows:]

Before the

SUBCOMMITTEE ON OVERSIGHT

of the

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

Joint Statement of

CARLOS A. SALADRIGAS, Chairman and CEO, Vincam Human Resources, and

TIMOTHY E. DOHERTY, Chairman and CEO, Doherty Employment Group

on

"The Staffing Firm Worker Benefits Act of 1997"
(H.R. 1891)

on behalf of the

NATIONAL ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS

and the

NATIONAL ASSOCIATION OF TEMPORARY AND STAFFING SERVICES

May 5, 1998

Madam Chairwoman and members of the Subcommittee, my name is Carlos A. Saladrigas. I am Chairman and Chief Executive Officer of Vincam Human Resources headquartered in Coral Gables, Florida. I am a past president and board member of the National Association of Professional Employer Organizations (NAPEO) and also am a member of the National Association of Temporary and Staffing Services (NATSS).

With me is Timothy E. Doherty, CEO of the Doherty Employment Group headquartered in Edina, Minnesota. Mr. Doherty is the immediate past president of NATSS and a current member of the NATSS Board. Mr. Doherty's company is also a member of NAPEO.

NAPEO represents over 500 PEOs throughout the United States. NATSS represents over 1600 temporary help firms, permanent placement agencies, PEOs, and other staffing services organizations.

This statement is submitted by NATSS and NAPEO in support of H.R. 1891, the "Staffing Firm Worker Benefits Act of 1997." This bill will enhance the ability of staffing firms to sponsor retirement plans and more generally will encourage the growth of such plans' coverage of workers in the small business sector. A technical summary of the bill is attached.

THE STAFFING SERVICES INDUSTRY

Robert G. Teal co-founded Silicon Valley startup Quinta Corporation in 1996. Teal was dismayed at the paperwork involved and the amount of time it took to hire and retain employees. His banker suggested that he seek assistance from a "professional employer organization" (PEO) to assume most of the human resources tasks of his fledgling company. The PEO helped hire Quinta's work force and recruit qualified engineers. It also offered its benefits program, allowing Quinta to match larger companies' packages. According to Teal, the ability to focus on his business - product development and technology - was one of the PEOs greatest benefits.[1]

In Pontiac, Michigan, 27 year old Karl Trevo was laid off his job in 1996 and turned to a temporary help firm, which placed him as an administrative assistant at Pontiac Osteopathic Hospital. His temporary assignment quickly led to a permanent job and two raises. In Gulfport, Mississippi a temporary help firm found Angela Edwards a receptionist job at Hollywood Park's Boomtown Casino. Within a few months, she so impressed her managers that they offered her a permanent job at $9 an hour with full benefits.[2]

These stories illustrate the extraordinary positive role "staffing firms" such as temporary help companies and PEOs are playing in the American economy -- providing increased worker independence, flexibility, and the opportunity to obtain skills training, better benefits, and greater job security.

Professional Employer Organizations PEOs are transforming the way small businesses manage their employer responsibilities and risks, allowing them to focus on their core businesses. At the same time, PEOs create economies of scale and scope that enable them to deliver better benefits to employees.

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[1] *Business Week Enterprise,* November 17, 1997

[2] Front page article, *Wall Street Journal,* March 4, 1998

PEOs are responsible for payroll, benefits, retirement plans, employment taxes, and workers' compensation. They implement client employment law compliance programs and work site safety policies, helping to reduce injuries and reduce costs. And by pooling employees of small businesses, PEOs bring millions of workers under the protection of federal laws applicable to large employers, such as COBRA and the Family and Medical Leave Act.

PEOs serve a wide range of small businesses from professional groups such as engineers and architects to small plumbing and electrical firms, travel agencies, florists, and manufacturing companies.

Temporary Help Firms For over fifty years, temporary help firms have helped businesses operate more productively by supplementing their work forces with skilled employees in every job category from industrial and clerical to professional and technical. Employees are assigned as needed to meet seasonal work loads, variable production schedules, and special projects.

Temporary work serves millions of workers who need job flexibility, supplemental income, skills training, and a "bridge" to permanent employment. Many prefer temporary work -- parents with young children, students needing summer employment, retirees looking for extra income and to stay active, as well as a growing number of highly skilled and highly paid professional and technical workers. Temporary help firms assume responsibility for wages, employment taxes and benefits, as well as workers' compensation and unemployment insurance.

In addition to the benefits afforded to workers and businesses, staffing firms ensure faster and more reliable payment to the government of billions of dollars of employment taxes annually through their automated payroll systems.

PEO Industry Facts

- Approximately 2,000 PEO firms operate in all 50 states.
- PEO revenues are in the range of $15 billion annually.
- An estimated 2 million workers are covered by PEO arrangements nationwide, less than 2% of employment.
- The average PEO has 1,000 "work site" employees under contract.
- The average PEO client has 18 workers.
- PEOs serve an estimated 2% of America's small businesses.
- Almost 90% of PEOs provide health insurance coverage to their work site employees. Over 75% provide 401 (k) plans.

Temporary Help Industry Facts

- An estimated 7,000 temporary help firms operate nationwide.

- Temporary help revenues in 1997 exceeded $50 billion in the U.S.
- Temporary help revenue growth averaged about 15% annually the past five years.
- 2.5 million people work for temporary help firms each day. *Annual employee turnover is about 400%.*
- Temporary jobs are 2% of total employment.
- Over 90% of American businesses use temporary help.
- 54% of temporary help firms offer health insurance; participation is low because most temporaries already have coverage and seek to maximize their cash incomes during the short time they work.
- 33% of temporary help firms offer retirement plans, mostly in high-tech jobs.
- Most temporary jobs lead to permanent employment. *In 1997, an estimated 7 million temporary employees found permanent work -- 2.9 million as a direct result of their temporary job.*

H.R. 1891 IS NEEDED TO CLARIFY THAT STAFFING FIRMS ARE EMPLOYERS AND TO EXPAND BENEFITS FOR THEIR EMPLOYEES

H.R. 1891 brings tax rules into the 21st Century by codifying the employer status of staffing firms for employment tax and benefit plan purposes. By recognizing those firms' legal status as employers, the bill ensures that the workers will continue to get the retirement, health, and other benefits offered by PEOs and other staffing firms.

- H.R. 1891 Provides That "Qualified" Staffing Firms Are Employers: Under the tax code, the determination of who is the employer is generally made by reference to the rules developed under common law. Common-law rules focus on who directs the worker at the work site. Because these outdated rules do not take into account the nuances of third-party staffing arrangements, the employer status of staffing firms and the validity of the benefit plans they maintain for their workers is uncertain.

  H.R. 1891 provides that staffing firms that meet the fundamental requirements of an employer will be treated as the employer for employment tax and benefits purposes even if the staffing firms' customers direct the employees' day-to-day work activities.

- Tests for "Qualified" Staffing Firms: To be "qualified" as the employer under H.R. 1891, staffing firms must provide staffing services under an agreement that provides that the firm assumes responsibility for:

  - Wages, employment taxes and benefits,
  - Hiring, reassigning and dismissing the workers,

- Maintaining employee records, and
- Addressing worker complaints, claims, or requests

- Protects and Expands Worker Benefits Without the bill, thousands of workers may be at risk of losing their health and pension benefits if the employer status of staffing firms is eroded because benefit plans will no longer qualify under the tax laws. Many also could lose protection under federal laws such as COBRA and the Family and Medical Leave Act because those laws exempt most small businesses. Clarifying that staffing firms are the employer will ensure that workers will continue to get these benefits. It also will encourage staffing firms to expand benefits, especially to employees working at small businesses.

- Protects Against Abuse The bill prevents retirement plan abuse by preserving the "leased employee" rules under section 414(n) of the tax code. Clients must still include "leased employees" in their head count for coverage and nondiscrimination testing purposes, which prevents businesses from giving certain high-paid employees better benefits than lower-paid employees.

Staffing firm employees remain protected under all federal and state labor and employment laws, including civil rights, wage and hour, occupational safety, and collective bargaining. The current rules for defining who is an employer under those laws are not changed by H.R. 1891.

SUMMARY AND CONCLUSION

Staffing firms are making a major contribution to the U.S. economy and are providing valuable job opportunities and benefits to millions of American workers. The ability of these firms to continue providing these jobs and benefits depends on their ability to assume legal responsibility as the employer for paying the workers' employment taxes and providing employee benefits. H.R. 1891 brings the tax law into line with these new work arrangements by codifying the employer status of staffing firms for those purposes.

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TECHNICAL SUMMARY OF
STAFFING FIRM WORKER BENEFITS ACT OF 1997

Overview. In general, the bill amends the Internal Revenue Code to make it clear that a "qualified staffing firm" is the employer of the employees covered by staffing arrangements, both for purposes of employment tax liability and for purposes of employee benefit plan sponsorship. The bill also amends the leased employee provisions of Code section 414 to encourage retirement and fringe benefit coverage of employees of qualified staffing firms.

Introduction/Section 1. Staffing firms serve a variety of business needs, and their services are referred to in a variety of ways, e.g., temporary help, long-term staffing, managed services, and professional employer arrangements. In the latter type of arrangement, primarily small to mid-size firms transfer their payroll and human resources functions to the staffing firm in order to concentrate on their core business. Staffing firms provide their services to customers on a contract or fee basis. The workers supplied by the staffing firm are paid by the staffing firm, and the staffing firm assumes the role of employer with respect to these workers in a number of ways, e.g., paying the workers' wages, paying employment taxes with respect to these wages, retaining authority for hiring, reassigning, and dismissing the workers, etc. Because of the nature of their work, though, staffing firm employees in many cases are under the day-to-day supervision of the customer where they work.

The relationship that staffing firms typically establish with customers is built on the fundamental premise that the staffing firm, and not the customer, is responsible to staffing firm employees who work at the customers' work site for the payment of wages, and to the extent applicable, any specified employee benefits. While in many staffing arrangements there is no question that the staffing firm is the employer of its employees under the traditional common-law test (see, e.g., Rev. Rul. 75-41, 1975-1 C.B. 323; Idaho Ambucare Center, Inc. v. United States, 57 F.3d 752 (9th Cir. 1995)), in other staffing arrangements this is less clear (see United States v. Garami d/b/a Tidy Maid, 184 Bankr. 834 (M.D. Fla. 1995)). For example, the Internal Revenue Service has established a market segment study of the "employee leasing" industry and is questioning whether, in certain types of arrangements involving staffing firms, the staffing firm is properly regarded as the "employer" for purposes of employment tax withholding and for purposes of maintaining employee benefit plans. An adverse holding on these issues could undermine the 401(k) and other benefits of staffing firm employees, as well as disrupt the business relationship between the staffing firm and the customer.

Section 2. This section of this bill is designed to codify the status of a "qualified staffing firm" as the entity with exclusive responsibility for federal employment taxes (income, FICA, and FUTA) with respect to a worker covered by a contract between the firm and its customer. Implicit in this rule is that the customer will not have liability for such employment taxes if, for some reason, the qualified staffing firm does not pay.

For these purposes, "customer" includes not only the party with whom the staffing firm contracts to provide the worker's services, but also any other party who receives the benefit of these services or who acts as payor for a party who is a customer. For example, assume qualified staffing firm M has entered an arrangement to supply staffing services to customer X, but cannot supply all the necessary workers for a particular job and pays qualified staffing firm N to supply staffing services to make up the shortfall. In this situation, neither qualified staffing firm M, nor its customer, customer X, would have

liability if, for some reason, qualified staffing firm N failed to meet its employment tax obligations for the workers assigned to the project.

This special rule is not intended to affect the classification of a worker as an employee or an independent contractor; it only identifies which of two parties is the employer of a worker who, under applicable law, would be classified as an employee of one of the two parties. The rule clarifies that the qualified staffing firm, and not the customer, is the employee's employer.

This rule applies whether or not the qualified staffing firm would otherwise be held to be the employer of the employee under the common-law test. No inference is intended as to the employer status of a qualified staffing firm under the common-law test. Thus, the rule applies even though the employee performs services for the customer and in some cases may function as an officer of the customer.

Section 2 (d) defines a "qualified staffing firm" for purposes of the special "employer" treatment accorded by the bill. This definition requires that the staffing firm must be liable for the worker's wages, the related employment taxes, and any agreed-upon employee benefits, without regard to the receipt or adequacy of the customer's payments. In addition, the staffing firm must have authority to hire, reassign, and dismiss the worker, must maintain employee records relating to the worker, and must have responsibility for addressing the worker's complaints, claims, etc., relating to employment. The fact that the customer may also have some involvement in these matters will not preclude a staffing firm from qualifying under this definition. Thus, the requirements of the definition will be met even though the staffing firm may take into account the customer's views in hiring or dismissing the worker, the customer may maintain its own set of records with respect to the worker, or the customer may share responsibility for addressing the worker's complaints, claims, etc.

Section 3. This section amends an existing rule in section 7701(a)(20) in the Internal Revenue Code for full-time life insurance salesmen. That rule treats such sales representatives, who otherwise would be classified as independent contractors, as common-law employees for purposes of certain specified employee benefits. This enables them to enjoy the tax-favored treatment that the Code affords such benefits when furnished to employees.

The bill does not alter the rule for the life insurance salesmen, but adds a new subparagraph (B) that is designed to treat individuals who would be treated as employees of the qualified staffing firm under the employment tax provisions as employees of such firm for purposes of the employee benefit provisions that are listed in the text. The employee benefit provisions include those relating to group-term life insurance, accident and health plans, profit-sharing and retirement plans (including 401(k) and savings plans, but excluding defined benefit plans), cafeteria plans, dependent care programs, educational assistance programs, employer-provided fringe benefits, VEBAs, and employee achievement awards. The bill also makes it clear that these individuals will be treated as employees of the staffing firm for purposes of applying the provisions of section 414(n), and thus may be counted as "leased employees" of the customer if the other requirements of section 414(n) are met. If these individuals are leased employees of the customer, then, of course, the same rules that currently apply with respect to the treatment of leased employees under the customer's plans will apply in the case of these workers.

In addition, the bill clarifies that a worker will be treated as having separated from service if the worker ceases to be employed by the customer and becomes employed by the qualified staffing firm, or

ceases to be employed by the qualified staffing firm and becomes employed by the customer. This will allow distribution of the worker's benefits under the 401(k) or retirement plan of the worker's prior employer. This provision is not intended to negate the application of the special leased employee service crediting rule under section 414(n)(4)(B).

Section 4. The bill contemplates that the general "leased employee" rule of section 414(n) will continue to apply to a customer. Under this rule, the customer must count a "leased employee" as its own employee for purposes of testing its plans under the IRS coverage and nondiscrimination rules.

Section 4(a) of the bill amends the leased employee provisions in section 414(n) so that they apply for purposes of section 401(k) and 401(m). This is intended to ensure that a customer will get credit, in accordance with section 414(n)(1)(B), for elective deferrals, matching contributions, and employee contributions, that are made on behalf of a leased employee.

Section 4(b) of the bill sets forth provisions for the treatment of qualified staffing firm employees under the qualified staffing firm's plans. These provisions allow a qualified staffing firm to elect, for any year, to have its plan tested under the coverage and nondiscrimination rules as if it were maintained by multiple employers, and as if the staffing firm's employees who are leased employees of a customer, or who would be leased employees of the customer but for the fact that they have not worked the requisite time period under section 414(n)(2)(B), were employed by the customer. The rationale for this rule is the fact that section 414(n) treats these employees, once they qualify as leased employees, as employees of the customer for IRS coverage and nondiscrimination rules. Under the circumstances, it is inappropriate to require these workers to be counted twice under the coverage and nondiscrimination tests, once by the customer and once by the qualified staffing firm, without affording the qualified staffing firm some relief under the coverage and nondiscrimination rules. Such relief will allow the staffing firm to provide levels of benefits that are more in keeping with the different competitive pressures each of its customers faces.

This provision affords comparable treatment in applying the nondiscrimination rules applicable to medical reimbursement plans under section 105(h) and cafeteria plans. Under a special rule, a qualified staffing firm electing to disaggregate its plan for these purposes may elect to treat all employees performing services for the customer as if they were employed by the customer for these purposes, regardless of whether they would qualify as leased employees, and may also elect to disaggregate only the employees working at selected customers. The qualified staffing firm's ability under this special rule to elect to disaggregate non-leased employees, or to disaggregate only those employees who work at selected customers, shall be subject to such additional conditions as the Treasury Department may prescribe in regulations to prevent abuse. Notwithstanding the foregoing, if the qualified staffing firm's plan covers a five-percent owner (within the meaning of section 416(i)) of the customer, the qualified staffing firm's plan must be disaggregated as to that customer for these purposes.

The bill also provides that if a separate employer segment of a qualified staffing firm's plan fails to meet the applicable IRS coverage and nondiscrimination rules, then the effect of disqualification will be confined to that segment of the plan. A special anti-abuse rule is included to make sure that employees who would be treated as highly compensated employees if they were employed by the customer are so treated under the qualified staffing firm's plan.

Section 5. This provision revises the current safe-harbor rule in section 414(n)(5) which allows a customer to disregard a leased employee for purposes of applying the coverage and nondiscrimination rules to its retirement or 401(k) plan if the leased employee is covered under a safe-harbor plan, and if leased employees in general comprise less than 20 percent of the customer's rank-and-file work force. Under the new safe-harbor plan requirements, only employees working for the particular customer desiring relief from the leased employee rules would have to be covered by the plan, not all employees of the qualified staffing firm who perform services for customers. The bill also reduces the level of required contribution under a safe-harbor plan from 10 percent to 7.5 percent. If the safe-harbor plan is a profit-sharing plan, contributions may not be distributed to the employee until the occurrence of an event permitting distribution under the section 401(k) rules, e.g., separation from service. As previously noted, an employee will be treated as having separated from service if the employee ceases to be employed by the qualified staffing firm and becomes employed by the customer.

Section 5(b) of the bill provides a safe-harbor rule for other employee benefit plans that would allow a customer to disregard leased employees for purposes of applying the coverage and nondiscrimination rules for employee benefit plans referred to in section 414(n)(3)(C) to the extent provided for in Treasury regulations.

Section 6. This section specifies the effective date of these provisions. Transition relief is afforded for existing plans.

Chairman JOHNSON of Connecticut. But thank you very much.

Mr. Caple.

STATEMENT OF ARTHUR N. CAPLE, JR., CHAIRMAN, LEGISLATIVE COMMITTEE, NATIONAL ASSOCIATION OF GOVERNMENT DEFERRED COMPENSATION ADMINISTRATORS

Mr. CAPLE. Thank you, Madam Chairwoman. I'd first like to thank Congressmen Cardin and Portman for the great leadership that they extended to the retirement community in being pro-active in addressing change in the past as it regarded retirement systems. And, Madam Chairwoman, I must say that it was music to my ears to sit back in the gallery to listen to you, and I was thinking about perhaps I ought to yield to the chairwoman because the comments that you made in this person's opinion were right on the money, and I think well beyond the testimony that was offered here today. And I think it's extremely delightful to have a chairwoman who chairs the committee that has an extensive knowledge of the subject that's being addressed. And I could agree with the couple of points that you addressed very strongly. I think you were, indeed, right on the issues.

I come here, Madam Chairman, today as I serve as executive director of the supplemental programs in Maryland, and we have a comprehensive program. Under our umbrella, we administer both 457, 403(b), and 401(k) programs. Additionally, I served for 13 years as a trustee on the Defined Benefit Board in Maryland, which is a sizeable, $26 billion defined benefit plan, and chair the investment committee for that group. I come today, also, as the chairman of the legislative committee for the National Association of Deferred Compensation Administrators, which is a national organization representing 49 States and some 5,000 counties and cities across the country.

I'm going to speak to the issues as it relates to the public sector primarily. I will try to cut my remarks short. You have the written testimony. We're running out of time, and I apologize for the head cold and the chest cold that I come with today, and also I'm on my last cough drop. [Laughter.]

So I will try to keep my comments short.

I think everyone has concluded that we have a retirement crisis. The question is now what do we do about the retirement crisis? How do we cut to the chase and get to the solutions to the problem? And that's somewhat of what we've been addressing today. I think that the Cardin-Portman bill is, again, another piece of legislation that goes right to the issues. I think it does a lot of good things for a lot of people. And I should tell the Congress people here today we have worked extensively, not only on this issue, but the trust issue in the public sector resulted in 457 money being placed in trust. And I want you to know that it effectively protected about $60 billion in public assets, public employee assets across the country. And in going through that exercise, I think that the people of America ought to know that the staff of the Ways and Means committee, the staff of the congressional offices were courteous, competent, and most importantly, always accessible. And that was of great assistance to us as we were trying to work through these very arduous issues.

I guess I'm going to try to paraphrase my comments and get to the issues. The subject of portability, and the question is why did that become important? All of you have heard it said that 90 percent of your total invested return is due to asset allocation, not to market timing. When we talk about employees investing their money they're going to have a portion of their money in the markets as well as fixed income products, and what's important is that they have it properly diversified. We now deal with a very portable workforce, particularly in the technological and professional area. If you would look at it this way, a person could change careers five or six times during their working career and they might go through six employers. That means that when they get to number five, they're going to have five different plans. On average, they're going to have somewhere between five and ten investment options in each of those plans. When they get to the fifth employer, if they've left everything where it is, they now have to deal with five different plans and 50 investment options and how any one can keep track of it, and balance and re-balance and get proper asset allocation is beyond me. So, if they can take it from "A" to "B" to "C" to "D," it greatly enhances their ability to manage their portfolio.

Secondly, there's an issue that has been addressed and we would welcome the opportunity to further discuss it. There's been a proposal to eliminate the 10 percent Federal excise penalty for money that goes into the 457 plan from 401(k) plan above—up to $50,000. We believe that that's going to create some administrative burdens on the plans that are receiving roll-over monies because now they have to do a separate accounting mechanism. They're going to have to keep—they're going to label the monies, if you will.

Chairman JOHNSON of Connecticut. That's a very valuable comment and, you know, those kinds of things if you could give us suggestions. Unfortunately, the red light is on so if you can, you're just about at the end of your testimony, so——

Mr. CAPLE. I've finished, Madam Chairman.

[The prepared statement follows:]

Testimony on: **PENSION ISSUES**

Before: **OVERSIGHT SUBCOMMITTEE OF THE WAYS AND MEANS COMMITTEE**

By: **ARTHUR N. CAPLE, JR.**
Chairman, Legislative Committee, NAGDCA (National Association of Government Deferred Compensation Administrators)

Date: **TUESDAY, MAY 5, 1998**

Testimony before the House Ways and Means Subcommittee on Oversight, Representative Nancy Johnson, Chair

GOOD AFTERNOON, MADAM CHAIRWOMAN, AND MEMBERS OF THE SUBCOMMITTEE.

MY NAME IS ARTHUR CAPLE AND I AM THE DIRECTOR OF THE STATE OF MARYLAND'S SUPPLEMENTAL RETIREMENT PROGRAMS. I ALSO CHAIR THE INVESTMENT COMMITTEE OF OUR STATE'S DEFINED BENEFIT PROGRAM.

I AM HERE TO TODAY AS CHAIRMAN OF THE NATIONAL ASSOCIATION OF DEFERRED COMPENSATION ADMINISTRATORS' (NAGDCA) LEGISLATIVE COMMITTEE AND AM PLEASED THAT CONGRESSMAN CARDIN HAS ASKED ME TO COME BEFORE YOU TODAY.

I COMMEND YOU, ON BEHALF OF NAGDCA, ON YOUR RECENT ACCOMPLISHMENTS IN THE PUBLIC PENSION ARENA OVER THE LAST SEVERAL YEARS. MOST NOTABLY, YOU DEVELOPED AND PASSED LEGISLATION TWO YEARS AGO, AS PART OF THE SMALL BUSINESS/ MINIMUM WAGE BILL, THAT PROTECTED, WHAT AMOUNTS TO ABOUT $60 BILLION IN ASSETS IN STATE AND LOCAL GOVERNMENT 457 PROGRAMS BY REQUIRING THAT THOSE FUNDS BE PLACED IN TRUST. YOU ACTED RESPONSIBLY ON THE HEELS OF THE ORANGE COUNTY, CALIFORNIA BANKRUPTCY, WHEN SUCH FUNDS WERE JEOPARDY. (PRIOR TO YOUR INTERVENTION, UNDER FEDERAL LAW, THOSE DOLLARS HAD BEEN THE PROPERTY OF THE EMPLOYER).

ADDITIONALLY, YOU HAVE PASSED OTHER CRITICALLY IMPORTANT PROPOSALS THAT HAVE ENHANCED RETIREMENT PLANS FOR THOUSANDS OF PUBLIC EMPLOYEES ACROSS THE COUNTRY. WE HAVE BEEN PLEASED TO HAVE THE OPPORTUNITY TO WORK WITH YOU AND YOU STAFFS, WHO HAVE ALWAYS BEEN EXTREMELY KNOWLEDGEABLE AND ACCESSIBLE. WE LOOK FORWARD TO CONTINUING TO WORK WITH YOU ON THE ISSUES OF PORTABILITY BETWEEN PUBLIC AND PRIVATE RETIREMENT PLANS.

LET ME JUST SUMMARIZE BRIEFLY THAT:

NAGDCA REPRESENTS 49 STATES AND OVER 5,000 LOCAL GOVERNMENT DEFERRED COMPENSATION ADMINISTRATORS, AS WELL AS OVER 600 INDUSTRIAL MEMBERS. THE PURPOSES OF THE ASSOCIATION ARE TO IMPROVE GOVERNMENTAL RETIREMENT PLANS THROUGH A SHARING OF INFORMATION ON INVESTMENTS, MARKETING, ADMINISTRATION RELATING TO PUBLIC SECTOR DEFERRED COMPENSATION PLANS; GATHER, DISSEMINATE, AND EXCHANGE INFORMATION RELATING TO PLANS; AND, IMPACT LAWS AND REGULATIONS CONCERNING DEFERRED COMPENSATION PROGRAMS THROUGH A UNITED EFFORT.

MY STATE OF MARYLAND OFFERS A COMPREHENSIVE PACKAGE OF SUPPLEMENTAL RETIREMENT PLANS, IN ADDITION TO OUR DEFINED BENEFIT PLAN, INCLUDING 401(k), 403(b) AND 457 PLANS. SO, WE HAVE EXTENSIVE EXPERIENCE WITH THE SUPPLEMENTAL RETIREMENT PROGRAMS WHICH ARE UNDER CONSIDERATION FOR CHANGE BY NUMEROUS MEMBERS OF CONGRESS, PUBLIC AND PRIVATE INTEREST GROUPS.

I AM PLEASED TO BE HERE TODAY, AS THERE HAS DEVELOPED AN INCREASED INTEREST IN THE ISSUE OF RETIREMENT AND THE PORTABILITY OF PRIVATE AND PUBLIC DOLLARS, SO THAT EMPLOYEES CAN EASILY MOVE THEIR MONEY, AS THEY CHANGE JOBS, MOVING FROM WORKPLACE TO WORKPLACE. AS YOU WELL KNOW, LEGISLATION HAS BEEN INTRODUCED WITH THE GOAL OF PROVIDING INCREASED RETIREMENT PORTABILITY AND MANY OTHER BILLS ARE IN THE PROCESS OF BEING DRAFTED.

ADDITIONALLY, THERE IS INTENSE DISCUSSION UNDERWAY REGARDING THE FUTURE OF SOCIAL SECURITY, AND MANY OF THE ISSUES THERE ARE NOT DISSIMILAR TO THOSE THAT MUST BE CONSIDERED WHEN LOOKING AT STATE AND LOCAL RETIREMENT PLANS. ISSUES OF FLEXIBILITY FOR PARTICIPANTS AND RETIREES; ISSUES OF EDUCATION OF EMPLOYEES REGARDING THE ARRAY OF PLANS AVAILABLE TO THEM; THE DIFFERENT RULES ACCOMPANYING PLANS; DISCLOSURE OF ADMINISTRATIVE AND INVESTMENT FEES; AND ENSURING THAT MONEY IS MAINTAINED FOR RETIREMENT PURPOSES; AND, THAT INVESTMENTS ARE SAFE--AT LEAST, THAT INDIVIDUALS HAVE AN OPPORTUNITY TO UNDERSTAND HOW THEIR MONEY WILL BE INVESTED.

NAGDCA SUPPORTS EFFORTS TO ENSURE THAT EMPLOYEES--BOTH PUBLIC AND PRIVATE--HAVE INCENTIVES TO SAVE FOR RETIREMENT AND AN INCREASED UNDERSTANDING OF THE OPPORTUNITIES AVAILABLE TO THEM. WE ARE ALSO CONCERNED THAT INDIVIDUALS UNDERSTAND CERTAIN RISKS AS WELL AS ADVANTAGEOUS FINANCIAL OPPORTUNITIES. AND THAT THEY BE GIVEN THE FLEXIBILITY TO MAKE **WISE** DECISIONS REGARDING

THEIR RETIREMENT INCOME.

NAGDCA SUPPORTS THE FOLLOWING CHANGES TO ALLOW FOR PORTABILITY OF PLANS BETWEEN EMPLOYERS, SIMPLIFICATION OF THE ADMINISTRATION OF PUBLIC PLANS, AND THE ENHANCEMENT OF OVERALL RETIREMENT SAVINGS FOR EMPLOYEES NATIONWIDE:

•ALLOW FOR ROLLOVERS BETWEEN PUBLIC AND PRIVATE SECTOR DEFINED CONTRIBUTION PLANS, INCLUDING 457, 401(k), 403(b), 401(a) PLANS AND IRA'S UPON SEPARATION OF SERVICES;

•ALLOW FOR INDEXATION OF CATCH-UP PROVISIONS FOR ANY PLAN THAT CURRENTLY HAS A CATCH-UP OPTION;

•REQUIRE LESS RESTRICTIVE RULES REGARDING 457 DISTRIBUTION PAYMENTS, THUS ALLOWING FOR CHANGES IN DOLLAR AMOUNTS BEING RECEIVED AS A DISTRIBUTION;

•REQUIRE THAT THE RECIPIENTS OF FUNDS UNDER DOMESTIC RELATIONS ORDERS (DRO'S) BE LIABLE FOR TAXES OWED ON MONEYS RECEIVED BY THIS INDIVIDUAL;

•SIMPLIFY THE CALCULATION FOR DETERMINING THE MAXIMUM CONTRIBUTION LIMIT FOR 457 PLANS;

•ALLOW PUBLIC EMPLOYEES TO PURCHASE SERVICE CREDITS WITH ANY OF THEIR DEFINED CONTRIBUTION PLAN DOLLARS.

MOST IMPORTANTLY, WE RESPECTFULLY REQUEST THAT AS YOU DRAFT LEGISLATION TO ADDRESS RETIREMENT PORTABILITY THAT YOU CONSIDER SEVERAL THINGS:

1. THE RULES OF THE CURRENT PUBLIC DEFERRED COMPENSATION PLANS ARE DIFFERENT UNDER FEDERAL LAW. AS MONEY IS ROLLED OVER FROM PLAN TO PLAN, EMPLOYEES MUST UNDERSTAND THE DIFFERENCES BETWEEN THE PLANS AND HOW THEIR DOLLARS MAY BE AFFECTED. FOR EXAMPLE, 457 MONEY IS VIRTUALLY IMPOSSIBLE TO ACCESS PRIOR TO RETIREMENT. HARDSHIP WITHDRAWAL REQUIREMENTS REQUIRE THAT AN EMPLOYEE EXPERIENCE AN "UNFORESEEN OR UNBUDGETABLE EVENT" IN ORDER TO WITHDRAW FUNDS PRIOR TO RETIREMENT. ON THE OTHER HAND, 401(k) PLANS OFFER LOANS TO EMPLOYEES AND THE MONEY IS EASY TO ACCESS.

ADDITIONALLY, THERE IS NO EARLY RETIREMENT PENALTY FOR 457 PLANS. AN EMPLOYEE MUST SIMPLY RETIRE TO BEGIN TAKING DISTRIBUTIONS. HOWEVER, THERE IS A 10% FEDERAL EXCISE TAX PENALTY IF A PARTICIPANT WITHDRAWALS 401(k) OR 403(b) MONEY PRIOR TO AGE 59 1/2. FIREFIGHTERS AND POLICE TYPICALLY RETIRE EARLIER AND SHOULD REALIZE THAT, IF THEY ROLL THEIR 457 MONEY INTO A 401(k), FOR EXAMPLE, THEY WILL FACE A PENALTY TAX IF THEY ATTEMPT TO WITHDRAW THE MONEY PRIOR TO AGE 59 1/2.

ALSO, 457 PARTICIPANTS HAVE LITTLE FLEXIBILITY IN CHANGING THEIR DISTRIBUTIONS ONCE THEY START TO RECEIVE THE MONEY, WHEREAS

OTHER PLANS ALLOW CHANGES IN DISTRIBUTIONS, SO ONE MAY FIND THEY HAVE LESS ABILITY TO CHANGE THEIR EARNINGS IF THEY HAVE ROLLED THEIR MONEY INTO A 457.

RECOMMENDATION: REQUIRE THAT DOLLARS TAKE ON THE FEATURES OF THE RECEIVING PLAN AND THAT THOSE PLANS NOTIFY THE PROSPECTIVE PARTICIPANT OF FEATURES OF THEIR PLANS THAT ARE DIFFERENT FROM THE PREVIOUS PLAN PRIOR TO THE ROLLOVER.

2. INVESTMENTS CAN BE RISKY AND CONGRESS SHOULD ENSURE THAT EMPLOYEES, WHILE EXERCISING INDIVIDUAL CHOICE, ARE PROTECTED, TO THE EXTENT POSSIBLE.

RECOMMENDATION: REQUIRE DISCLOSURE OF ALL INVESTMENT AND ADMINISTRATIVE FEES AND SUPPORT EFFORTS AND PROGRAMS THAT SEEK TO EDUCATE RETIREMENT ADMINISTRATORS (BOTH PUBLIC AND PRIVATE) AND THAT ENSURE THAT EMPLOYEES ARE EDUCATED ABOUT AVAILABLE PLANS AND INVESTMENTS.

NAGDCA LOOKS FORWARD TO WORKING WITH YOU TO ADDRESS THE ABOVE ISSUES.

THANK YOU FOR THE OPPORTUNITY TO TESTIFY TODAY.

I WOULD BE PLEASED TO ANSWER ANY QUESTIONS FROM THE COMMITTEE.

Chairman JOHNSON of Connecticut. Mr. Wray.

STATEMENT OF DAVID WRAY, PRESIDENT, PROFIT SHARING/ 401(K) COUNCIL OF AMERICA, CHICAGO, ILLINOIS

Mr. WRAY. Thank you very much. I am David Wray, president of the Profit Sharing/401(k) Council of America, an association that for the past 50 years has represented companies that sponsor profit sharing and 401(k) plans for their employees. We have approximately 1,200 company members who employ approximately 3 million plan participants. Our members range in size from a six employee parts distributor to firms with hundreds of thousands of employees. PSCA has 290 members with less than 100 employees.

Small companies, those with 100 employees or less, employ nearly one-third of the workers over the age of 25. However, small companies, as we know, sponsor considerably fewer plans than large companies. For these small companies that sponsor tax qualified retirement plans, the financial commitment is high. PSCA has found that companies with fewer than 50 employees contribute an average of 35.1 percent of their total net profits to their profit sharing plans. The average cost of the match in a 401(k) plan of that size is 32.6 percent of the total net profits. In contrast, companies with more than 5,000 employees have average profit sharing contributions of 8.3 percent of total net profit, and 401(k) matches that represent 3.9 percent of net profit. Of course, large companies are far more likely than small firms to offer a defined benefit plan as well.

One of the most challenging tests facing our society is the accommodation of our continually increasing life span. Until the last generation, it was the human experience that people worked until they died. In just a few seconds on the human clock, that has changed. It is now no longer exceptional that people live to be 100 or for couples to celebrate their 50th wedding anniversaries.

One of the tools helping us financially adjust to this change is the defined contribution retirement plan. This employer, employee, Government partnership mechanism has proved to be one of the greatest engines of individual wealth accumulation ever devised. Collectively, defined contribution plans, which include 401(k), profit sharing, ESOP, money purchase, 403(b), and 457 plans, hold more than $2 trillion in assets. Further, more than 80 percent of the $1.5 trillion in IRA's is the result of roll-overs from the private retirement system. In 1978, the year that 401(k) was passed, these programs had less than $200 billion in assets. This was only 20 years ago.

Historically, most small companies have found it economically impossible to sponsor retirement plans, even defined contribution plans, because of the continual changes in the tax law, complicated Government regulation, and intense marketplace competition. They also suffer from complexity intimidation. Many small companies are terrified of the IRS and will not participate in programs that are so complicated that the rules can be inadvertently violated. To expand small business retirement plans, several actions are required. Regulatory costs need to be lower and plan regulation needs to be simplified. The benefits of a retirement plan as a tool to attract and retain valued employees need to exceed plan costs

and employers and key employees must be able to benefit from the plans.

Women are a substantial portion of the small company workforce. They represent the fastest growing segment of the small business community, and they own roughly 40 percent of the 23 million small businesses in the United States. Further, a recent study indicates that, given the chance, women save greater percentages of their income and participate at a higher rate in 401(k) plans than their male counterparts. The most effective way to expand retirement benefits for women is to make defined contribution plans more available to small businesses.

Congress took important steps in this direction with the passage of the Small Business Protection Act of 1996 and the Taxpayer Relief Act of 1997. It can take another significant step forward by passing the Retirement Security for the 21st Century Act. The passage of this legislation will increase retirement savings, simplify administrative burdens, and lead to expanded employer provided retirement plans for American workers, especially women workers who work for and run small businesses.

As my time is running out, I will just comment that H.R. 3788 is bold and visionary. Madam Chairwoman, you and the other sponsors of this legislation deserve the gratitude of the millions of American workers who will benefit from its passage. You have the enthusiastic support of the members of the Profit Sharing 401(k) Council of America.

Thank you very much.

[The prepared statement follows:]

PSCA

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SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS

HEARING ON OVERSIGHT OF VARIOUS PENSION ISSUES MAY 5, 1998

Small Companies Need Qualified Plans To Provide Retirement Benefits To Their Employees, Especially Women Employees

The Profit Sharing/401(k) Council of America (PSCA) is a non-profit association that for the past fifty years has represented companies that sponsor profit sharing and 401(k) plans for their employees. PSCA has approximately 1200 company-members who employ approximately 3 million plan participants throughout the United States PSCA's members range in size from a six employee parts distributor to firms with hundreds of thousands of employees. PSCA has 290 members companies with less than 100 employees. All members regard their profit sharing or 401(k) plans as vital factors in their business success.

Small companies (i.e., those with fewer than 100 employees) employ nearly one third of US workers over the age of 25.[1] However, only 42 percent of these small employers offer a qualified retirement plan to their employees,[2] compared with 80 percent of large employers.[3] Many small companies find it economically impossible to sponsor qualified retirement plans because of continual changes in the tax law, complicated government regulation, and intense competition.

This has serious implication for women in the workforce as they represent the fastest growing segment of the small business community. Roughly 40 percent of the 23 million small businesses, employing 18.5 million people in the United States, are women owned.[4] Further, a recent study indicates that given the chance, women save greater percentages of their income and participate at a higher rate in 401(k) plans than their male counterparts.[5]

For those small companies that sponsor tax-qualified retirement plans, the financial commitment is high. PSCA has found that companies with fewer than 50 employees contribute an average of 35.1 percent total of their total net profits to their profit-sharing plans; the average 401(k) plan employer matching contribution for companies this size was 32.6 percent of total net profit. In contrast, companies with more than 5,000

employees averaged a profit-sharing contribution of 8.3 percent of total net profit and a 401(k) match of 3.9 percent of total net profit[6].

Small companies have unique needs

If small companies are to participate more fully in the qualified plan system, the regulatory framework within which they operate must address the following small-business realities:

- *Small-company qualified plans need to be less costly to administer.* It does not make sense for employers to pay plan-related administrative expenses of several hundred dollars per year per participant when the company contribution for an employee is $1,000 or less.

- *Small-company qualified plans need to be simple to understand.* Small company owners will not initiate programs they themselves do not understand. Small companies have neither the expertise nor the money to support comprehensive communications programs aimed at explaining how their plan works.

- *The benefits of small-company qualified plans should extend beyond the incentive of tax deferrals.* In addition to encouraging the accumulation of assets for retirement and personal savings, the benefit of tax deferral for qualified plans often is not sufficient to offset the significant costs that employers incur to fund and administer even the most basic plan. Qualified plans need to be flexible enough to help employers attract potential employees, retain current employees and increase employee motivation.

- *The owner/employee and key employees should also be able to benefit personally from small-company qualified plans.* Owner/managers run nearly all small companies and personally incur the costs required to fund and administer qualified plans, because those costs come directly from their profits. Tax deferral incentives for qualified plans must be sufficient enough to help offset some of these costs or owner/managers will opt to choose other ways to accumulate assets for their own retirement without establishing a plan that would provide retirement benefits to their employees.

We must simplify the regulatory environment for small employers

PSCA believes that more small companies will use profit-sharing and 401(k) plans -- and therefore provide retirement benefits to more workers, especially women workers -- only if government regulation is simplified. When a small company weighs the economic feasibility of a retirement plan, the costs added by regulatory complexity often tip the scales away from plan formation. PSCA urges government policymakers to continue to reexamine regulatory policies with an eye toward simplification. This

regulatory relief can be provided without in any way sacrificing the protections intended to assure that workers' retirement benefits are safe.

Specifically, PSCA endorses The Retirement Security for 21st Century Act, sponsored by Representatives Portman and Cardin. For example, this legislation eliminates an administratively expensive and unnecessary regulation that had the effect of limiting profit sharing contributions for and salary deferrals by lower paid employees, especially women with intermittent work lives. It restores contribution limits to something approaching their 1983 levels on an inflation adjusted basis. It provides regulatory relief that will benefit company plans of all sizes, with special regulatory relief for small businesses.

This legislation will increase retirement savings, simplify administrative burdens and lead to expanded employer-provided retirement programs for American workers, especially for women workers who work for and run small businesses.

Providing retirement benefits for small-company employees

As America's baby-boom generation ages, the need to provide adequate retirement benefits becomes more pressing. It is gratifying that Congress is increasingly focused on retirement security. Because one-third of the US workforce is employed by small businesses where there is limited participation in the private retirement system, the quickest and most efficient way to expend retirement plan coverage is to make qualified retirement plans more attractive to small businesses. Congress took important steps in this direction with the passage of the Small Business Protection Act of 1996 and the Taxpayers Relief Act of 1997. It can take another significant step forward by passing The Retirement Security for the 21st Century Act.

Congress needs a rational approach to tax expenditures

Congress must consider the revenue impact of improving the private retirement security system. The latest Tax Expenditures Tables prepared by the Joint Committee on Taxation staff indicates that the estimated loss of revenue for FY 1998 due to the exclusion of employer contributions to a qualified plan and the earnings on plan assets is $73.5 billion, the largest tax expenditure figure in the tables. It represents the total revenues "lost" for state, federal, and military pensions as well as private retirement plans. Private plans represent less than a third of the total tax expenditure notwithstanding that millions more persons are covered than in all the public plans combined. Largely overlooked is that retirement plans are a tax-deferred arrangement. Every dollar put into the plan and every dollar of earnings thereon is ultimately taxed. The revenue loss is ultimately recovered.

The deferral of the tax is obviously a major tax benefit, but it also represents extremely sound fiscal and social policy. Qualified employer plans play a critical role in ensuring retirement security for Americans. Trust fund assets (at last count $5 trillion) are a major

source of investment capital in our booming economy. None of these factors is taken into account by government revenue estimators. Private retirement plan tax treatment is an investment that improves retirement security, generates current revenue by providing investment capital, and produces future revenue as baby boomers retire and draw their retirement plan benefits. The tax deferral benefit actually costs much less than many other tax incentive programs Congress has devised over the years.

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[1] Table 15, Pension Coverage, Participation and Benefit Entitlement Status Among Civilian, Non-Agricultural Workers Aged 25 and Older, 1991, in Paul Yakoboski and Celia Silverman, Retirement Income Security: The Situation of Current Retirees and Prospects for Current Workers (Employee Benefit Research Institute, May 4, 1994)

[2] Table 4.3, *Participation in Benefits Provided By Medium and Large Private Establishments*, in EBRI Databook of Employee Benefits, Fourth Edition (Employee Benefit Research Institute, 1997)

[3] Table 4.2, *Participation in Benefits Provided by Medium and Large Private Establishments*, in EBRI Databook of Employee Benefits, Fourth Edition (Employee Benefit Research Institute, 1997)

[4] SBA Administrator Hails Gains By Women Business Owners As the Nation Marks Women's History Month. SBA Number 98-13, March, 1998.

[5] Robert Clark, Gordon Goodfellow, Sylvester Schieber, Drew Warsick, "Making the Most of 401(k) Plans: Who's Choosing What and Why", April, 1998

[6] Table 8, Company Contributions as a Percentage of Total Net Profit by Plan Type and Size, in 40th Annual Survey of Profit Sharing and 401(k) Plans (Profit Sharing Council of America, 1997).

Chairman JOHNSON of Connecticut. Thank you, Mr. Wray.

Ms. Franzoi.

STATEMENT OF LYNN FRANZOI, SENIOR VICE PRESIDENT, BENEFITS, FOX GROUP, ON BEHALF OF U.S. CHAMBER OF COMMERCE

Ms. FRANZOI. Thank you. Madam Chair and members of the Subcommittee on Oversight of Pension Issues, my name is Lynn Franzoi. I am senior vice president of benefits for Fox Group. I appear before the subcommittee today on behalf of the U.S. Chamber of Commerce.

The U.S. Chamber of Commerce is the world's largest business federation representing more than 3 million businesses and organizations of every size, sector, and region of the country. We are pleased to appear before you today to discuss pension reform, and, in particular, the Retirement for the 21st Century Act introduced by Representatives Portman and Cardin. The U.S. Chamber applauds your leadership in seeking ways in which our Nation's pension laws can be reformed in a positive manner. Today, we would like to focus our attention on the Retirement Security for the 21st Century Act and the positive changes it brings to our pension laws. In the interest of time, I will focus on a select number of issues of importance to the business community. However, I ask that a copy of my testimony be submitted for the record.

The U.S. Chamber believes that the over-riding goal of any pension reform legislation should be to ease regulatory burdens on employers that sponsor retirement plans. In particular, we believe that every effort should be made to enact those changes with the greatest potential for expanding pension coverage within the small business community. As you know, cost is a major deterrent to pension plan sponsorship within the small employer market. Legislation that seeks to reduce administrative cost on employers will make pension plan sponsorship more attractive as a business proposition.

To that end, we support proposals that would modify or repeal the top heavy rules. The top heavy rules are a major deterrent to plan formation within the small business community. The proposal contained within the Portman-Cardin legislative package will go a long way toward making 401(k)'s more attractive and affordable for small employers. While we favor outright repeal of top heavy, we strongly support the proposed modifications.

We also support the proposed changes to the SIMPLE IRA. While SIMPLE has proven to be a success during its first year of existence, creating a salary reduction only SIMPLE will allow employers that may not be in a financial position to afford matching or employer contributions the opportunities to allow their employees to save on a tax deferred basis.

Other favorable changes to the pension law that the Chamber supports include the following: increasing the benefit and compensation limits to allow individuals to contribute more and to accrue greater benefits in their pension plans; enhancing pension portability; repeal of the 25 percent of compensation limit as it applies to defined contribution plans; encouraging direct reinvestment of ESOP dividends; repealing the 150 percent of current liability

full funding limits for defined benefit plans; repealing the multiple-use test; changes to the separate line of business rules; and changes to the same desk rule.

These are but a few of the proposed changes included in the package. While there are numerous other provisions that we equally support, in the interest of time I've limited my comments to the above. However, I would like to mention an issue that seems overlooked when policy makers discuss women's pension rights. One way to significantly improve the retirement security of women in this country is to expand coverage within the small business community. According to the Small Business Administration, women own approximately 40 percent of all businesses in America and this percentage is anticipated to grow to over 50 percent early in the next century. And more women work for small employers, or small businesses than they do for large employers. The lack of coverage within the small business community is a women's pension issue and I encourage you to look closely at this when contemplating pension reform.

In closing, I want to say that the U.S. Chamber stands ready to assist you and the Congress in enacting sensible pension reform legislation that will encourage and expand pension coverage. To that end, we support the Portman-Cardin pension legislative package as a model for successful pension reform.

I thank you.

[The prepared statement follows:]

Statement of the U.S. Chamber of Commerce

ON: PENSION REFORM AND H.R. 3788, THE RETIREMENT SECURITY FOR THE 21st CENTURY ACT

TO: SUBCOMMITTEE ON OVERSIGHT OF THE HOUSE COMMITTEE ON WAYS AND MEANS

DATE: MAY 5, 1998

BY: LYNN FRANZOI

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 71 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance -- numbers more than 10,000 members. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 83 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT

on

Pension Reform and

H.R. 3788

The Retirement Security for the 21st Century Act
for the

U.S. Chamber of Commerce
by

Lynn Franzoi
May 5, 1998

Madam Chair and members of the Subcommittee, my name is Lynn Franzoi. I am Senior Vice President of Benefits for Fox Group. I also chair the Qualified Plan Subcommittee of the U.S. Chamber of Commerce, and I appear today on behalf of the Chamber federation.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region of the country. We are pleased to appear before this subcommittee to discuss the issue of pension reform and our support for H.R. 3788, the Retirement Security for the 21st Century Act. The U.S. Chamber of Commerce strongly endorses this bi-partisan legislative package. The bill restores much of the attractiveness of qualified retirement plans lost through innumerable changes to the Employee Retirement Income Security Act of 1974 (ERISA) through legislation enacted during the 1980's and early 1990's. It is our view that H.R. 3788 will help to expand coverage within the small business

community, will ease administrative complexity for plans large and small, and will provide enhanced incentives for individuals to participate in saving for retirement through their employer-sponsored retirement plan. In short, the legislation creates a regulatory environment that encourages participation by employers and employees in the voluntary retirement system. While there are numerous provisions within H.R. 3788 that we endorse, we limit our comments to some of the more visible changes.

I. Regulatory Relief for Plan Sponsors

A. Expanding Coverage within the Small Business Community

The U.S. Chamber believes that any meaningful pension reform legislation must focus on changes that will increase coverage within the small business community. The current regulatory environment under which plans must operate today acts as a major deterrent to small business plan sponsorship. Considering the size and growth of the small business sector of our economy, we are concerned that the complexity of our pension laws works to deny millions of Americans who make their living in small business, access to retirement planning options through their employer. A Congress that is sincerely interested in encouraging expanded coverage within the small business community must seek ways to provide incentives for plan sponsorship while also limiting the regulatory impediments that stifle such growth.

In testimony presented before the Senate Labor Committee earlier this year, the Chamber stated that cost is the major impediment to plan sponsorship within the small business community – both in terms of employer contributions and plan administration. We support H.R. 3788 because it attempts to reduce both of these costs. For instance, the proposed changes to the top heavy rules included in the legislation will allow small

employers to sponsor 401(k) plans while reducing their fear that they will be subjected to mandatory employer contributions that they cannot afford. The top-heavy changes also will work to ease the administrative costs employers incur to determine top heavy status and remain compliant with the rules. While we would prefer outright repeal of these outdated and unnecessary rules, the modifications contained in H.R. 3788 will help remove a significant barrier to plan sponsorship within the small business community. Enactment of these changes will send a strong signal that Congress is serious about reforming our pension laws to encourage small business participation in the employer-sponsored retirement system.

The legislation also clarifies that top heavy relief applies to the 401(k) safe harbor plans that employers will be allowed to offer beginning next year. While these safe harbor plans, enacted as part of the Small Business Jobs Protection Act of 1996, will allow companies to reduce administrative costs in exchange for meeting certain contribution requirements, the safe harbor plan designs are unusable if the plans remain subject to top heavy requirements. The change proposed in H.R. 3788 will ensure that these safe harbor plan designs can be utilized by employers of all sizes as a means for allocating more of their scarce resources towards benefits for plan participants and less towards administration.

One of the biggest surprises to emerge from the Small Business Jobs Protection Act was the creation of the SIMPLE IRA plan for small employers. During its first year of existence, over 31,000 employers adopted SIMPLE IRA plans, with continued growth anticipated for this year. While early signs are encouraging, the proposal in H.R. 3788 to

increase the contribution limits for the SIMPLE IRA may make the plan even more attractive to small business owners and their employees.

While the SIMPLE IRA is proving to be a successful retirement plan option for many small employers, H.R. 3788 takes the SIMPLE IRA concept one step further and adds a salary-reduction-only plan as an additional option for small employers. For many small employers that are unable to afford a SIMPLE IRA with its contribution requirements, or the administrative cost of a traditional 401(k) plan, a salary reduction SIMPLE IRA may prove attractive as an inexpensive means for providing tax-preferred retirement savings opportunities for employees.

There are numerous additional provisions included within H.R. 3788 that pertain specifically to the small business community. We are encouraged by their inclusion within this package.

B. Regulatory Improvement

Our nation's voluntary employer-sponsored retirement system is designed around tax incentives to encourage employers to provide retirement savings opportunities for their employees. However, the regulatory environment under which the system operates places more emphasis on rules and regulations than on providing benefits to plan participants. The current state of our retirement system faces a staggering array of regulations that place increasing burdens and costs on employers who voluntarily choose to offer retirement plans to their employees.

To its credit, H.R. 3788 seeks to peel away some of the current statutory provisions that have been demonstrated to be especially onerous for employers – and which provide little protection for plan participants. We focus our comments here on a

few of the many, particularly burdensome rules that should be repealed or severely reformed.

Under current 401(k) rules, plans are subject to what is known as the multiple use test, which is an addition to the nondiscrimination tests that already apply to employee contributions and employer matching contributions. This is a particularly onerous rule that few plan administrators understand, making compliance difficult at best. Also, considering the nondiscrimination testing that already applies to 401(k) plans, the multiple use test is superfluous. To the extent that H.R. 3788 seeks to repeal the multiple use test, it will eliminate an unnecessary administrative compliance requirement imposed on plans while not compromising protections for plan participants.

Employers with complex business formations face another burden called the separate-line-of-business rule. We submit that this Code provision, which is designed to allow employers to test their retirement plans on a separate-line-of-business basis, is simply unworkable and serves no valid purpose in its present form. Thus, we support proposals that would simplify the separate-line-of-business rule and allow for the allocation of employees among lines of business based upon a facts and circumstances test.

There are numerous additional regulatory changes proposed in H.R. 3788 that are sensible approaches to pension reform. For instance, by allowing employees to elect to reinvest within their company ESOP dividends paid on their ESOP shares, and allowing the employer a deduction for such reinvested dividends, the legislation will enhance employee stock ownership while increasing retirement savings. Also, providing employers with greater flexibility in applying the coverage rules and increasing the cash-

out amount for small benefit accumulations both provide relief from regulatory burdens that simply increase compliance costs.

II. Plan Participants

A. Pension Portability

The Chamber appreciates the efforts by policymakers to enhance the ability of America's workers to take their pension assets to their new employer when they change jobs. In a highly mobile work environment, portability is an important means to reduce leakage from the system as more employees are encouraged to take their pension to their new employer, rather than accessing and spending those retirement savings.

A major barrier to portability, however, is the Internal Revenue Code. Employers are faced with rigid and unbending rules regarding benefit options provided under qualified plans that in many instances, discourage or prohibit employers from accepting account transfers from other plans that don't maintain identical benefit options. H.R. 3788, along with Representative Pomeroy's legislation, H.R. 3503, seeks to address this problem by facilitating the transfer of account balances among different types of qualified plans and Individual Retirement Accounts. While we believe the portability rules can be made even more lucrative, they nonetheless represent a valuable change that will create more incentives for employees to keep their money in the retirement system.

Another Code provision that discourages portability is the so-called same desk rule. The same desk rule places restrictions on a participant's access to retirement benefits when they work in the same position for a new employer following a sale of their former employer's assets. Employees faced with this change in business ownership

should have access to their retirement benefits from their former employer – and H.R. 3788 facilitates this through modifications to the same desk rule.

One supposed portability issue that we do oppose, however, is the shortened vesting schedule for employer matching contributions. Not only do we not regard shortened vesting as portability; we believe it simply represents increased costs for employers. We would encourage this provision to be stripped from any pension reform legislation.

B. Enhancing Participant Contributions and Benefits

While policymakers constantly remind Americans of the importance of saving for retirement, they simultaneously impose restrictions on our ability to do so on a tax-deferred basis. Limiting the amount of benefits a participant can accrue under a defined benefit plan or accumulate under a defined contribution plan, simply reduces retirement savings. A similar result occurs through limiting the amount of compensation that can be considered for purposes of determing such benefits.

The U.S. Chamber believes that Americans should be encouraged to save for their retirement to the best of their financial ability. If individuals are to be encouraged to take more responsibility for preparing for their retirement years, Congress must seek to foster an environment where such savings can occur. To this end, the Chamber has long supported restoring the benefits and compensation limits that apply to qualified plans, to their historic limits. Thus, to the extent that H.R. 3788 increases the benefit limit for defined benefit plans, increases the defined contribution limit, increases the limits on employee contributions to 401(k) plans and SIMPLE IRAs, and increases compensation

limits, the legislation will make significant strides in restoring the attractiveness of qualified plan to employers and their employees.

The Chamber also views the repeal of the 25% of compensation limitation on contributions to defined contribution plans as one of the more important provisions within H.R. 3788. By eliminating this provision, the legislation removes a barrier that precludes many low and middle income participants from saving at levels they may otherwise desire and be able to achieve. It also will help to eliminate situations where employers are forced to drop or severely curtail profit sharing or other employer contributions to their defined contribution plans because such contributions, when coupled with employee contributions, push many lower paid employees over the 25% limit.

A new idea that is receiving the attention of policymakers is allowing employees who are over the age of 50 to make catch-up contributions to their employer's 401(k) plan. The policy goal is to allow individuals who may not have saved adequately for retirement the ability to close this savings gap during their remaining working years. We applaud this concept but are concerned that applying nondiscrimination rules to catch-up contributions will make the proposal meaningless for small employers – the group that may be most in need of such a catch-up opportunity.

Finally, H.R. 3788 includes a change in the funding rules for defined benefit plans that the Chamber has long supported. Repealing the 150% of current liability funding limit for defined benefit plans will send a message to companies that Congress is serious about allowing for responsible and sensible pre-funding of retirement benefits. The change will help to ensure that companies can fund the benefits they promise to plan

participants in a more rational fashion, helping to strengthen the funding of promised benefits and leading to greater benefit security for plan participants. Such a change, along with the phase-in of the PBGC's variable rate premium, may act as an inducement to draw small employers once again into defined benefit retirement sponsorship.

III. Conclusion

The U.S. Chamber of Commerce applauds the efforts by Chairwoman Johnson to make reform of the private retirement system a priority. We also thank Representatives Portman and Cardin for their efforts in crafting a piece of legislation that will go a long way towards removing barriers to pension coverage within the small business community and provide relief to employers of all sizes from overly burdensome rules and regulations. While we have not discussed all of the provisions in this comprehensive legislative package, we believe the package as a whole represents sound pension reform. We stand willing to assist you as you move this legislation through Congress in a bi-partisan fashion.

Chairman JOHNSON of Connecticut. Thank you very much.

Mr. Hawkins.

STATEMENT OF RUSS HAWKINS, VICE PRESIDENT, BENEFITS, ALLIED SIGNAL, INC., MORRISTOWN, NEW JERSEY

Mr. HAWKINS. Thank you for this opportunity to express our support for legislation that would enhance retirement savings by giving employees the option to reinvest dividends earned on company stock held in an ESOP.

As Vice President for Benefits, I am responsible for overseeing our benefit programs for Allied Signal's 70,000 workers. As a 30 year employee with the company, I can speak to Savings Plan issues, both from the standpoint of an administrator, but also as a long-term employee.

At 10.6 percent, employees are the single largest group of company shareholders. We take pride in that and want that percentage to increase even more. Our employee-owners are building wealth and sharing in the growth and success of the company.

Our Savings Plan is one of the most generous in the country. New employees may begin participating as soon as hired. And after one year, we match 50 percent of employee contributions. After five years, we match 100 percent of employee contributions up to 8 percent of their compensation.

There are 11 investment options for employee contributions. These include bond funds, equity funds and company stock. Employee decisions are entirely up to them. We do not encourage or discourage employee investment in company stock. In our communications with employees, we stress the importance of having diversified portfolios.

We are proud of the USA Today article, which we've shared with you, that features our Savings Plan. It highlights one employee who has accumulated a balance of $500,000. This employee has been in the plan for 20 years and has accumulated these savings without even contributing the maximum amount. We project her nest egg will grow to $1 million by the time she retires.

But she is not alone. We have 157 employees with account balances over $1 million. Most of these are not company executives, but rather employees at various salary levels. In fact, of 157 employees, 35 of them earn less than $80,000 and only 25 earn more than $150,000. We have over 4,000 employees with account balances over $250,000, and of these, 3,000 of them earn less than $90,000.

We believe strongly in employee ownership which is why we contribute company stock to the Savings Plan to match employee contributions.

Our Savings Plan is an ESOP as it is primarily intended to be invested in employer stock. ESOPs provide an efficient means of accumulating assets for retirement and an ownership interest in the employer.

Over the years, Congress has enacted pro-ESOP legislation to encourage employers to establish and maintain ESOPs. One such benefit, which we utilize, allows companies under certain circumstances to deduct dividends paid on company stock held in the ESOP. The availability of this deduction was a significant factor in

Allied Signal's decision to increase the matching contribution in 1987 from 50 percent to 100 percent. This increase has resulted in greater retirement savings for our employees.

But in order to take the dividend deduction, the law mandates that we pay dividends to plan participants in cash—passing them through the Savings Plan directly to the participants. Our employees routinely complain when they receive their dividend checks. They believe that the dividends belong in the Savings Plan where they could grow for retirement. As you well know, dividends that are reinvested in a Savings Plan would over time provide a greater amount to tax at retirement.

We support efforts to increase retirement savings and avoid unnecessary leakage in the private retirement system. Why encourage current spending when there is such a significant need to increase retirement savings?

The Internal Revenue Service has ruled that employers may provide for the equivalent of automatic re-investment, but only if they jump through administrative hoops, and create a structure that is complex, difficult to understand and explain to employees. To complicate things further, the IRS does not allow all employees to qualify for the automatic reinvestment equivalent.

Legislation that would allow employers to provide directly for dividend reinvestment without the need for IRS rulings, regulations, and paperwork would vastly simplify the system and provide equal treatment for all employees.

I applaud you, Madam Chairman, for including this employee option in the ESOP Promotion Act of 1997, and Congressmen Portman and Cardin for including this proposal in The Retirement Security for the 21st Century Act. There's also strong bipartisan support for the proposal on the Senate side.

I thank you for this occasion to present the views of AlliedSignal and its employee-owners. I urge the subcommittee to act on this legislation at the earliest opportunity.

[The prepared statement follows:]

Testimony of

Russ Hawkins
Vice President, Benefits
AlliedSignal Inc.

before the

SUBCOMMITTEE ON OVERSIGHT
WAYS AND MEANS COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

Tuesday, May 5, 1998

Thank you Madam Chairman and members of the Subcommittee for this opportunity to express our support for your proposals to enhance retirement savings by giving employees the option to reinvest dividends earned on company stock held in an ESOP.

As Vice President for Benefits I am responsible for overseeing all benefit programs for AlliedSignal's 70,000 workers, including health and welfare, retirement savings and H.R. mergers and acquisitions. And as a 30 year employee with the company, I can speak to Savings Plan issues both from the standpoint of an administrator, but also as a long-term employee.

At 10.6 percent, employees are the single largest group of company shareholders. We take pride in that and want that percentage to increase even more. Our employee-owners are building wealth and sharing in the growth and success of the company.

Our Savings Plan is one of the most generous in the country. New employees may begin participating as soon as they are hired. After one year, we match 50% of employee contributions, and after 5 years of matched participation we match 100% of employee contributions up to 8% of their compensation.

There are 11 investment options for employees to choose from for their own contributions. These include bond funds, equity funds and various asset allocation funds that employees can choose from consistent with their own investment goals, as well as a company stock fund. Employee investment decisions are entirely up to them. We do not encourage or discourage employee investments in company stock. In our communications with employees we stress the importance of having a diversified portfolio.

We are proud that *USA Today* featured our Savings Plan prominently in this recent article which I have shared with you.

One employee highlighted in the article has accumulated a Savings Plan balance of almost $500,000. Rosemary Ganley has been contributing to the Plan for about 20 years and has accumulated these savings without even contributing the maximum annual amount. We project that her nest egg will grow to over $1 million by the time she retires.

Rosemary is not alone. We have 157 employees with account balances over $1 million. Most of these are not company executives, but rather employees at various salary levels who save year after year, and who benefit from our generous matching contribution. In fact, of the 157 employees with $1 million dollar account balances, 35 of them earn less than $80,000 a year, 132 of them earn less than $150,000, and only 25 earn more than $150,000 a year.

We have over 4,000 employees with account balances over $250,000, and over 3,000 of them earn less than $90,000 a year. The average account balance in our Savings Plan is $116,000.

We believe strongly in employee ownership which is why we contribute company stock to the Savings Plan to match employee contributions.

Our Savings Plan is an ESOP as it is primarily intended to be invested in employer stock. ESOPs provide for an accumulation of assets for retirement and the provision of an efficient means of accumulating an ownership interest in the employer.

Over the years Congress has enacted pro-ESOP legislation to encourage employers to establish and maintain ESOPs. One such benefit, which we utilize, allows companies under certain circumstances to deduct dividends paid on company stock held in the ESOP. The availability of this deduction was a significant factor in AlliedSignal's decision to increase its matching contribution in 1987 from 50% to 100% of each dollar contributed, up to 8% of compensation after 5 years of a match. This increase has resulted in greater retirement savings for our employees.

But in order to take the dividend deduction, the law mandates that we pay dividends to plan participants in cash – passing them through the Savings Plan directly to the participants. Our employees routinely complain when they receive their dividend checks. They believe that the dividends belong in the Savings Plan where they could grow for retirement. And as you well know, dividends that are reinvested in a savings plan would over time provide a greater amount to tax at retirement.

We support efforts to increase retirement savings and avoid unnecessary leakage in the private retirement system. Why encourage current spending when there is such a significant need to increase retirement savings?

We would like to give our employees the option to leave the dividends in the plan for automatic reinvestment, and strongly support the legislative proposals that would do so.

The Internal Revenue Service has ruled that employers may provide for the equivalent of automatic reinvestment – but only if they jump through administrative hoops, and create a structure that is complex and difficult to understand and explain to employees. And to complicate things further, the IRS does not allow all employees to qualify for the automatic reinvestment equivalent.

Creative employers can form additional complex structures to provide for a reinvestment equivalent for most of the employees that do not qualify under the IRS rulings. But for one group of employees -- middle managers who tend to save a lot – no reinvestment equivalent is available.

Legislation that would allow employers to provide directly for dividend reinvestment, without the need for IRS rulings, regulations and paperwork would vastly simplify the system, and provide equal treatment for all employees.

We believe that each employee should be allowed to choose whether to receive dividends in cash or have them remain in the plan for automatic reinvestment, without affecting the employer's deduction.

I applaud you, Madam Chairman, Congressman Levin and others who included this employee option in "The ESOP Promotion Act of 1997," and Congressmen Portman and Cardin for including this proposal in "The Retirement Security for the 21st Century Act." There is also strong bipartisan support for the proposal on the Senate side, as the proposal is included in the companion ESOP and Retirement Security bills.

I thank you for this occasion to present the views of AlliedSignal and its employee-owners. And I urge the Subcommittee to act on this legislation at the earliest opportunity. I would be happy to answer any questions you may have.

Chairman JOHNSON of Connecticut. Thank you very much, Mr. Hawkins.

Mr. Weizmann.

STATEMENT OF HOWARD C. WEIZMANN, MANAGING CONSULTANT, WATSON WYATT WORLDWIDE

Mr. WEIZMANN. Good afternoon. I am Howard Weizmann, managing consultant of the Washington office of Watson Wyatt Worldwide. I want to thank you, Madam Chairman, and members of the Subcommittee on Oversight for sponsoring these hearings. I also especially want to thank Congressmen Portman and Cardin for their tireless work in developing this legislation.

It is my pleasure to discuss with you today, H.R. 3788, Retirement Security for the 21st Century Act, and our strong belief that this legislation will cure many ills that have plagued our Nation's pension system in recent history. I manage an office of 300 consultants and pension actuaries, within a company that was a pioneer in the area of pensions. Watson Wyatt Worldwide has a developed defined benefit, defined contribution and hybrid pension plans for the largest, most successful corporations in America, and the tiniest companies in America.

I'm a benefits attorney by trade, and for years, I managed the benefit team at a Fortune 100 company. In the late 1980's, I ran the Association of Private Pension and Welfare Plans. In my 20 plus years in the business, I've been fortunate to see it from all sides: tax practitioner, benefits administrator, an employer, a consultant, and a lobbyist.

First, let me say, that we very strongly support the Retirement Security Act. The multitude of regulation and legislation enacted to further exact equity and feed the deficit has eroded the very core and significance of ERISA. The greatest casualty in the fiscal wars of the 1980's and the supposed pursuit of tax equity was American savings policy. In the name of deficit reduction, a plethora of new legislative requirements and regulations hobbled the private pension system which had, until the 1980's, been a growing and necessary component of private savings.

Between 1980 and 1990, 560 pages of regulations dealing with employee benefits, mostly pension benefits, was issued by IRS, and the figures don't lie. During that same period, from 1975, actually, to 1987, the number of pension plans was halved. To paraphrase the old cliche, "If you can't fix it, don't break it." The pension system wasn't broken and wasn't perfect in 1980, and today it is less perfect, unfortunately, after the 560 pages of new regulations and legislation. The bill before you today would go along way toward restoring the meaning and the simple beauty of ERISA.

My message is simple and straightforward. Complex pension rules inhibit coverage and limit benefits. Our clients, in many cases, represent the largest, most successful corporations in America, and their pension funds routinely spend six and sometimes seven figures per year on regulatory compliance, not because they want to but because they have to. I know firsthand of cases in which the cost of compliance equaled or exceeded the benefits provided. I also know by anecdote that these rules keep employers from sponsoring the pension plans. When we look at our clients

and other large corporations who provide a defined benefit contribution plan for their active and retired workforce, we see dollars that could be used to other purposes, such as enhancing retirement benefits.

The Bible reminds us that those who sow the wind, reap the world wind. While the pursuit of tax equity and deficit reduction may have been driven by a notion of ideological purity, the practical result has generally been less coverage and, because of the growth of unfunded non-qualified pension benefits, more insecurity for workers, not greater security. By increasing the current limits under the various sections specified in the act, and by cutting through the legislative and regulatory underbrush choking the system, the legislation begins to reverse the erosion in coverage brought about by the blind pursuit of these policies.

One additional consideration, not formerly mentioned, was that as we consider the possible incorporation of individual savings under Social Security, as well as the Government's role in providing a retirement income safety net, we must focus on the role that private pension should and could play. By increasing the incentives associated with corporate and individually sponsored private retirement vehicles, by reducing the complexity of both, we can target increased, not decreased, increased Social Security benefits on more needy individuals, individuals not otherwise eligible for retirement benefits from private sources. Under such a scheme, Social Security benefits become a floor for only the most needy. Additional incentives for funded private pensions ensure that adequate retirement income will be available to employees through the private system. Throughout this debate, I've heard for many years we tried to make the private system stretch and fit all. We do have, in fact, a national retirement system and it is called Social Security. Both have a role to play and we should allow each one to play it.

In the end, in summary, we really applaud the sponsors for introducing this legislation. George Santayana, the philosopher once defined fanatics as those who redouble their efforts while forgetting their aim. We have spent the last 15 years chasing the illusion of virtue while creating the vice of reduced coverage. My hope that when all is done and this bill has become law, we'll never again allow the pursuit of arcane public policies and deficit reduction to derail our efforts at covering more Americans under the private system.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF HOWARD C. WEIZMANN

ON

OVERSIGHT OF PENSION ISSUES

PRESENTED TO THE SUBCOMMITTEE ON OVERSIGHT

OF THE COMMITTEE ON WAYS AND MEANS

TUESDAY, MAY 5, 1998

Howard C. Weizmann
Managing Consultant
Watson Wyatt Worldwide

Good afternoon. I am Howard Weizmann, Managing Consultant of the Washington office of Watson Wyatt Worldwide. It is my pleasure to discuss with you today the Retirement Security for the 21st Century Act. My testimony will focus less on the particulars of this bill than on the ills that it will cure. My message is simple and straightforward: complex pension rules inhibit coverage.

Let's first put my remarks into context. I manage an office of 300 consultants and pension actuaries, within a company that has pioneered in the area of pension creation and management for over 50 years. Watson Wyatt has developed defined benefit, defined contribution and hybrid pension plans for the largest, most successful corporations in America. I am a benefits attorney by trade, and for years, I managed a benefits team at a large Fortune 100 company. In the late 1980's, I ran the Association for Private Pension and Welfare Plans. In my twenty plus years in this business, I've been fortunate to see it from all sides: as a tax practitioner, benefits administrator, consultant, and lobbyist.

The 1980's were a period of growth and dynamism. Enlightened legislation aimed at reducing taxes and de-regulation of inefficient and cumbersome monopolies unleashed the power of the marketplace, setting the stage for what is today a remarkable economic renaissance in our country's history. And while the big issues of tax reform were continually decided in favor of increasing growth and opportunity, a battle raged over spending and deficits during these years. I was an active and outspoken participant in seeking to protect the private pension system from predatory budget-cutters.

The greatest casualty in the fiscal wars of the eighties was American savings policy. In the name of deficit reduction, a plethora of new legislative requirements and regulations hobbled the private pension system, which had until the 1980's been a growing and necessary component of private savings. Between 1980 and 1990 over 560 pages of regulations dealing with employee benefits, mostly pension benefits, were issued by the IRS. And the figures don't lie: while the total number of private defined benefit plans increased from 103,000 in 1975 to 175,000 in 1983, by1987 that number was more than halved.

These legislative changes crippling the private pension system were enacted throughout the decade and fall into three broad categories: social agenda issues, deficit reduction and tax policy.

It is pointless to rehash the issues covered by the 1980's social agenda and deficit reduction efforts. Those debates are long over and, for better or worse, American business and the American people have grown used to the changes. In dramatic contrast, let us recall the legislation enacted to further arcane tax policy issues. These provisions continue to burden the private pension system and limit its ability to cover more people. The bill at hand – Retirement Security for the 21st Century – would provide exactly that, by eliminating these pointless and obsolete provisions.

Let us go into a bit more detail on tax policy.

Historically, tax-favored plans were designed to avoid discrimination in favor of highly compensated individuals. Prior to 1989, the IRS enforced these rules on the basis of all facts and circumstances. Pension plans that demonstrated application to a fair cross-section of employees qualified for limited tax advantages under the internal revenue code. To allow employers that compete in different industries a measure of relief, rules permitting employers to test their retirement plans using *separate line of business* were originally included in legislation. In 1989, this fair cross-section test was replaced by a series of mechanical tests. And thus, the IRS' regulatory approach to the *separate line of business* rules guaranteed to provide employers nothing but illusory and in attainable relief.

The 1980's also saw the erosion of limits associated with the maximum amount an individual could receive from a tax-qualified retirement plan – all in the name of tax equity. When compared to the original limitations under the Employee Retirement Security Act of 1974 (ERISA), these provisions represent a mockery of the original limits. Congress also enacted additional financial limitations that may be taken into account in determining benefits under tax-qualified plans.

Let's put this in practical terms. Defined benefit limits for employees aged 65 are presently set at $130,000, compared with the $221,000 expected had this benefit not been frozen. In addition, since 1989 there have been caps on the amount of pay that can be taken into account in a qualified plan. The cap is currently $160,000. Prior to 1989, there was no cap on pay. In everyday use, this cap limits the age 55 and the age 65 benefit below these levels.

In developing these legislative changes – and certainly throughout the regulatory process - no one in Congress or in the regulatory agencies took the opportunity to pose three critical questions:

1) ***Was discrimination in favor of highly paid employees sufficient to warrant legislative and regulatory relief?***

I'd like to suggest that if it ain't broke, don't fix it. Prior to the issuance of these regulations, there was never any proof that discrimination under tax-qualified plans indeed existed. Likewise, no one has ever demonstrated that the current rules have resulted in increased retirement benefits for anybody. Today, Congress' more enlightened view of regulation places the burden of demonstrating the need for regulation on those seeking additional rules. In sum, we've "not" fixed a problem that never was.

2) ***What is the impact of reducing the tax incentives associated with tax-qualified plans and the addition of complicated regulations for determining non-discrimination on overall coverage under tax-qualified retirement plans?***

Coverage under tax-qualified retirement plans stagnated over the last decade. While the causes for this stagnation are varied, the lessening of tax incentives associated with

providing these benefits eroded potential individual and corporate plan sponsors' desire to establish new plans. One only needs look at the popularity of 401(k) plans to understand the power of incentives for both executives and rank and file. Few remember that 401(k) was originally slated for elimination under the original Administration tax proposals that led to the Tax Reform Act of 1986 also for reasons of tax equity. The Treasury Department report to the President in November of 1984 is illustrative of the tax equity agreement. "The ability to make deductible contributions to tax favored retirement plans should be made available on a broad and consistent basis." The proposal was to do away with the potential under the then law of making a 401(k) contribution of $30,000 in favor of increasing IRA contributions by $500. Fortunately, cooler heads prevailed and the 401(k) limits were simply reduced.

Aside from the erosion of tax incentives, the additional complexity linked to setting up and maintaining tax-qualified plans under new complicated non-discrimination rules dampened the establishment of new plans. I remember a conversation with a colleague who established a Simplified Employee Pension or SEP. His accountant had originally suggested that he establish such a plan for himself and his employees. When faced with the complex requirements of this legislation, he informed me with some pride, that he decided to terminate the plan—and with some measure of rough justice, his accountant as well.

The lack of new plan formation suggests that this decision has been repeated again and again.[1] Those of us who have long labored in this area have watched successive Administrations and Congress seek to replace the allure of tax incentives with exemption from the complicated rules they themselves created. The bones of SEPs and "Power" plans lay bleached by the sun of ineffectiveness. They underscore the fact that, until now, no one has been willing to address the real issue: The law for regular tax-qualified plans is too complex to understand, to follow, and to enforce. Congress recognized this in its incorporation of simplification in the Small Business Job Protection Act. "Physician-- heal thyself" should be the watchwords that attach to this legislation.

3) What the appropriate balance between issues of nondiscrimination, complexity and coverage?

The original ERISA limitations were severely eroded beginning in 1982 when Section 415 limits on benefits to highly compensated individuals were frozen, and again in 1986, when limits were enacted regarding the amount of income on which benefits could be based. Caps on benefits to highly compensated employees limited income replacement for individuals in this category, for which Social Security represents only a small component of their overall retirement benefit.

[1] The total number of private pension plans increased from 311,000 in 1975 to 733,000 in 1987, then declined to 702,097 1993. The total number of private defined benefit plans increased from 103,000 in 1975 to 175,000 in 1983, then declined to 83,596 in 1993. The total number of private defined contribution plans rose continuously from 208,000 in 1975 to 619,700 in 1992, then fell to 618,501 in 1993.

In response, employers adopted non-tax-qualified supplemental executive retirement plans, or *SERPs,* to replace executive benefits lost by virtue of the reduced tax limitations. Since the benefits under such plans are not tax advantaged, there are no requirements that average workers participate. Moreover, these plans are not funded—relying instead on the employer's naked promise to pay the retirement benefit out of general corporate assets.

Over the past 15 years, SERPS have become commonplace in most large companies. With each additional limitation, the liabilities under such plans have grown, affecting employees earning $80,000 per year—a significant income, but hardly uncommon. The overall result of the pursuit of tax equity is that coverage for rank and file employees has not kept pace with the growth in benefits for higher paid workers. Additionally, almost all major companies now have substantial unfunded liabilities, payable to large numbers of employees out of unsecured corporate assets—a situation not unlike that which led to the establishment of ERISA.

The Bible reminds us that those who sow the wind, reap the whirlwind. While the pursuit of tax equity may have been driven by a notion of ideological purity, its practical result has been generally less coverage and more insecurity for workers. By increasing the current limits under sections 415, 401(a)(17), 401(k), and elsewhere, and by cutting through the legislative and regulatory underbrush choking the system, this legislation begins to reverse the erosion in coverage brought about by the blind pursuit of tax equity.

Coordination of Private Pension Plan Incentives with Social Security

It's no secret that Social Security is a hot-burner issue. In introducing this legislation at the same time substantial Social Security reform is under consideration, Congress is presented with a unique opportunity. It's time to reconsider the approach that's led to the traditional three-legged stool of the American retirement landscape: The first leg is Social Security; the second, private pensions; and the third, individual savings.

As we consider the possible incorporation of individual savings under Social Security, as well as the government's role in providing a retirement income safety net, we must focus on the role that private pensions should play. By increasing the incentives associated with corporate and individually sponsored private retirement vehicles and by reducing the complexity of both, we can target increased Social Security benefits on more needy individuals—individuals not otherwise eligible for retirement benefits from private sources. Under such a scheme, Social Security benefits become a floor for only the most needy. Additional incentives for funded private plans ensure that adequate retirement income will be available to employees through the private system.

Such an approach has several distinct advantages. Primarily, it ensures that the truly needy will receive adequate benefits in retirement. It also leverages retirement income provided under private pensions. Finally, since there would be relatively fewer Social

Security beneficiaries, the pay-as-you go funding scheme which is jeopardized today by the declining ratio of workers to retirees, would regain its efficacy.

Once again, this legislation is a natural platform on which to craft a coordinated retirement income policy for the nation.

In summary, we applaud the sponsors for introducing this legislation. Georges Santayana, the philosopher, once defined fanatics as those who redouble their efforts while forgetting their aim. We have spent the last fifteen years chasing the illusion of virtue, while ignoring the path along which we traveled. My hope is that when all is done and this bill has become law, we will never again allow the derailment of our efforts to cover more Americans under public and private pensions.

Chairman JOHNSON of Connecticut. Amen. I hope we—that we will do pension policy in the context in the goals and objectives of the program. I thank the panel very much for their testimony. Because of the impending votes, I'm not going to ask any questions but I take very seriously the comments that you've made and invite you to contribute to the project of thinking beyond the box, as well as resolving the smaller problems within the Portman-Cardin bill that we certainly will be paying attention to.

Mr. Coyne.

Mr. COYNE. I have none.

Chairman JOHNSON of Connecticut. Mr. Portman.

Mr. PORTMAN. Just briefly, again, to thank the panel. The portability issue is one, Mr. Caple, I think that we didn't get into enough today that we need to focus more on. I think it's one of the great benefits of this because it does just reflect what's really going on out there. Mr. Wray, talking about the limits and so on, we appreciate the Council's help, Sam Murray and others putting it together. Lynn, thank you for the Chamber's work, and David Kemps also has been a very big help in that.

In the interest of time, I'm not going to get into the ESOP provisions. We talked about them earlier. I know your company has been at the forefront on providing benefits and you're very interested in the ESOP provision. I hope we do what is necessary in terms of providing a deduction should there be a reinvestment which seems to make a lot of sense. Mrs. Johnson has separate legislation on that, and Howard Weizmann, that historical perspective was very interesting. Tax equity and deficit reduction has led to this sort of, unholy alliance between the two.

I'll just say with regard to the staffing firms, I know Mr. Ramstad may want to talk more about that, but, I think, again, it reflects reality. You have these staffing firms out there providing retirement benefits, these smaller businesses are not going to provide them. And you want to be the employer right?

Mr. SALADRIGAS. That is correct.

Mr. PORTMAN. Why do you want to be the employer? People ask me, why would you want the IRS to consider you the employer?

Mr. SALADRIGAS. Well, the answer is very simple. I think we heard today how difficult it is for small businesses to meet the burdens of being an employer and to provide affordable, quality benefits to working Americans. What we provide for these businesses is a benefit & human resource out-sourcing solution. It is a turn-key system whereby a small business can focus on the business of their business while we provide employees with health benefits, pension benefits, and a full suite of human resource administration. We assume those responsibilities because we're better equipped, and better able, and more knowledgeable to manage and discharge those responsibilities. However, for the staffing industry to provide an out-sourcing solution, we need to clarify & codify our employer status for tax and benefit plan purposes.

Mr. PORTMAN. And you will assume those responsibilities, including collective bargaining agreements?

Mr. SALADRIGAS. For collective bargaining agreements, basically the law is very clear on that. PEO comply with the terms of a collective bargaining agreement. Federal courts have found a joint

employer relationship where each of two employers "exert significant control over the same employees." PEOs enjoy good relations with Unions. So, this is not an issue. PEOs are co-employer in both union & non-union workplaces and endorse the right of employees to organize, or not organize, in accordance with the NLRB.

Mr. PORTMAN. Okay. Thank you very much. Mr. Doherty, I know you have more, I'll defer to Mr. Ramstad. Thank you.

Chairman JOHNSON of Connecticut. Mr. Ramstad is an important member of this committee. I am sorry that he was not able to join on until late. That happens on Tuesday when we're all commuting. Mr. Ramstad?

Mr. RAMSTAD. Yes, thank you, Madam Chair, and I am sorry that I was late because of a delayed flight from Minneapolis. I want to thank all the panelists, particularly, Tim Doherty, who's a prominent business person in the third district in Minnesota, chairman and CEO of Doherty Employment Group in Edina. My thanks to you and your colleague for your joint testimony in support of the legislation that I have cosponsored with my good friend and colleague, Rob Portman, H.R. 1891.

For the reasons you point out, this is very important legislation, obviously, and I wish we had more time to dialogue but the vote is pending. I just want to, again, thank you for coming out here to Washington to help us with this legislation.

Thank you, Madam Chair.

Chairman JOHNSON of Connecticut. Thank you very much. The hearing will adjourn.

[Whereupon, at 5:15 p.m., the hearing was adjourned subject to the call of the Chair.]

[Submissions for the record follow:]

STATEMENT OF THE

AIR LINE PILOTS ASSOCIATION

FOR THE RECORD OF THE HEARING

U. S. HOUSE OF REPRESENTATIVES

COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

MAY 5, 1998

OVERSIGHT OF PENSION ISSUES AND H.R. 3788

The Air Line Pilots Association ("ALPA") is the collective bargaining representative of 49,000 pilots who fly for 48 United States and Canadian airlines. ALPA appreciates this opportunity to submit comments to the Subcommittee on Oversight of the House Ways and Means Committee, on pension issues and H.R. 3788, "Retirement Security for the 21st Century Act," for the record of the hearing held May 5, 1998.

ALPA wholeheartedly supports the reforms in tax and labor laws proposed in H.R. 3788. In particular, ALPA endorses the bill's restoration, to previously effective levels, of the qualified plan compensation limit and the limits on qualified plan benefits and contributions. This restoration will allow union employees to see their negotiated retirement benefits paid from funded qualified plans, rather than from unfunded employer sources. The maintenance of adequately funded plans is especially crucial where retirement benefits have been collectively bargained, since employees have traded immediate cash wages for the promise of security in retirement.

For the same reasons, ALPA strongly advocates the bill's provision phasing out and ultimately repealing the 150% of current liability funding limit. This arbitrary limit stands as a clear-cut case of tax revenue policy defeating retirement policy. Contributions which should have been made by employers to ensure the adequate funding of pension plans have not been made, solely because of this arbitrary limit. Abolishing the limit will restore the funding of pension plans to a system based, logically, on sound actuarial principles.

ALPA also endorses the bill's proposals concerning employees' elective deferrals to 401(k) plans. Not only would the annual limit on deferrals be raised for all employees, with additional deferrals allowed by employees age 50 or older, but the deferrals would be subject to a separate limit for purposes of the employer's deduction. These are just the kinds of reforms needed to boost individual savings for retirement. Together with private pension plans and Social Security, individual savings have long been recognized as a critical source of retirement income and security.

We believe that one area of the bill requires slight modification in order to make most of these reforms available earlier to certain union employees. Section 101(h) of the bill contains a provision delaying the effective date of the reforms covered by Section 101 to collectively bargained plans. While these reforms will apply to most employees beginning in 1999,

they will not apply to employees participating in collectively bargained plans until as late as 2003. As a union, ALPA understands and appreciates that the goal in providing such a delayed effective date is to prevent the situation in which employers and unions are *required* to bargain over the changes, during the term of the collective bargaining agreement currently in force on the date of enactment. However, with only a minor modification to the bill, this goal may be achieved while still allowing the reforms to be available to employees whose unions and employers *want* to engage in bargaining over the new law during the term of the current collective bargaining agreement. In this regard, ALPA suggests that the following sentence be added at the end of Section 101(h)(2) of the bill:

> "Notwithstanding the foregoing, the employer(s) and employee representative(s) who are parties to a collective bargaining agreement ratified by the date of enactment of this Act may agree to the earlier application of the amendments made by this section, but not earlier than the first year beginning after December 31, 1998."

ALPA also suggests an additional conforming change be added to the bill, addressing Internal Revenue Code Section 415(b)(9), in view of other modifications the bill makes to Section 415. Specifically, we suggest the following revision, formatted to show modifications to present law:

> **"(9) Special rule for commercial airline pilots.**
>
> (A) In general. Except as provided in subparagraph (B), in the case of any participant who is a commercial airline pilot-
>
> (i) the rule of paragraph ~~(2)(F)(i)(II)~~ (2)(F)(i) shall apply, and
>
> (ii) if, as of the time of the participant's retirement, regulations prescribed by the Federal Aviation Administration require an individual to separate from service as a commercial airline pilot after attaining any age occurring on or after age 60 and before ~~the social security retirement age,~~ age 62, paragraph (2)(C) (after application of clause (i)) shall be applied by substituting such age for ~~the social security retirement age~~ age 62.
>
> (B) Individuals who separate from service before age 60. If a participant described in subparagraph (A) separates from service before age 60, the rules of paragraph (2)(F) shall apply."

In closing, ALPA applauds the Subcommittee in its effort to improve retirement security and simplify retirement plan administration. If the Subcommittee has any questions concerning these comments, please contact Mr. David R. Vance, Director, Retirement and Insurance Department, Air Line Pilots Association, 535 Herndon Parkway, Herndon, Virginia, 20170, telephone (703) 689-4113.

Statement for Written Record of
the Subcommittee on Oversight of
the House Ways and Means Committee
Hearings on Various Pension Issues

May 5, 1998,

by

The ESOP Association
1726 M Street, NW, Suite 501
Washington, DC 20036

Supplemental Sheet to The ESOP Association's Statement for Written Record of the Subcommittee on Oversight of House Ways and Means Committee Hearings on Various Pension Issues, May 5, 1998

Name of Witness: J. Michael Keeling
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Testify for: The ESOP Association, a 501(c)(6) national trade association with over 2,100 members who sponsor employee stock ownership plans, or ESOPs.

Statement Submitted for the Written Record of the Subcommittee on Oversight's Hearings on Various Pension Issues, May 5, 1998 [Release No. OV-16]

Chair Johnson, and members of the Oversight Subcommittee, I am Michael Keeling, President of The ESOP Association, a national trade association based in Washington, D.C., with over 2,100 members nationwide, two-thirds of which are corporate sponsors of Employee Stock Ownership Plans, or ESOPs, and other members are either providing services to ESOP company sponsors, considering installing an ESOP, or affiliated with an educational, or non-profit institution.

A little indulgence before turning to the substance of The ESOP Association's statement for your hearings on "various pension hearings", as announced in Committee Press Release OV-16. You may not realize this fact, but your focus on an ESOP issue as part of your hearings on pensions, savings, and deferred compensation plans, is part of a strong tradition of the Oversight Subcommittee to include a review of employee ownership issues as part of its role for the full Ways and Means Committee as the lead Subcommittee on pension and ERISA issues. By my count, this is the fourth time I have either appeared or submitted a statement pertaining to ESOPs to this Subcommittee.

May I state that it is very pleasing to the employee ownership community to know that the Subcommittee, through the leadership of Chair Johnson, continues its interest in ESOPS and employee ownership, as it did under Chair Johnson's predecessor, former Congressman J. J. Pickle of Texas.

Again, I appreciate your indulgence in my making these observations.

We come today because the press release announcement for today's hearings set forth that the likely subject matter for review includes: [Among other things] "(5) the treatment of reinvested Employee Stock Ownership Plan dividends...."

The treatment of reinvested Employee Stock Ownership Plan, or ESOP, dividends, is addressed in Section 4, of H.R. 1592, the ESOP Promotion Act of 1997, introduced May 14, 1997.

Let the record note that Chair Johnson, and Subcommittee members Ramstad and Thurman are all original co-sponsors of H.R. 1592, developed by Congressman Cass Ballenger, a senior member of the House Education and Workforce Committee.

Other members of the Ways and Means who are co-sponsors of H.R. 1592, and thus indicating an interest in this topic of the treatment of reinvested ESOP dividends are Representatives Levin, McCrey, Neal, and Jefferson.

So the questions are, "What is Section 4 of H.R. 1592, why is it in H.R. 1592, and how does it meet the key goals expressed by Chair Johnson 'to see whether Congress should prune the law in order to make the system stronger....'? "

The ESOP Association strongly believes that the answer to all of these questions will persuade this Subcommittee to recommend to the full Committee that any tax bill addressing pension issues include Section 4 of H.R. 1592 as one of its provisions.

So, let us answer the questions set forth above:

What is Section 4 of H.R. 1592? To answer the question, we first have to understand current law pertaining to dividends paid on stock in an ESOP. [Note, an ESOP is a tax-qualified defined contribution plan that must be primarily invested in employer securities that may borrow money to acquire employer securities. In other words, it is an ERISA plan that is akin to a tax-qualified profit sharing plan. An ESOP must comply with all the laws, regulations, and regulatory guidance pertaining to ERISA plans, plus many unique, Congressionally sanctioned incentives and restrictions to ensure ESOPs are both "ownership" plans, and secure "ERISA" plans.].

Internal Revenue Code Section 404(k) provides that dividends paid on ESOP stock are tax deductible if they are passed through in cash to the employee participants in the ESOP, or if they are used to pay the debt incurred by the ESOP in acquiring its employer securities, and the employees receive stock equal in value to the dividends. This section of the Code was added to the tax code in 1984, and modified in 1986, and in 1989.

Section 4 of H.R. 1592 provides that if a sponsor of an ESOP pays dividends on ESOP stock that may be passed through the ESOP in cash to the employee, and the employee in turn has indicated that he or she would like the dividends "reinvested" in the sponsor's dividend reinvestment program, the sponsor can still take the Section 404(k) deduction.

Now, to the second question asked above -- Why would Mr. Ballenger, Mrs. Johnson, et al want to have this Section 4 be considered. Well the reason is simple, but typical of most of our tax law, we have to be careful to make the simple explanation understandable.

The IRS has taken the position that when the employee voluntarily authorizes his or her dividends on his or her ESOP stock to be reinvested in the ESOP sponsor's dividend reinvestment program, the value of the dividends is **not** tax deductible for the ESOP sponsor.

Let me repeat what I just said -- if the employee wants to reinvest his or her dividends on ESOP stock in more stock to be held in the ESOP or a co-ordinated 401(k) plan in order to have more savings, the IRS says, **"No tax deduction".** Think about it, the IRS is saying, "spend the money now, do not save it for the future," or at least that is the impact of the position.

But the situation in the real world gets even worse in the view of ESOP advocates, as there is a way for the plan sponsor to keep its tax deduction and for the employee to save more by keeping his or her dividends in a 401(k) plan. But this way is convoluted to a great extent, requiring the creation of some legal fictions that serve no purpose except to make life more complex and expensive for the sponsor of the ESOP and 401(k) plan.

Again, here is the explanation. There is a technique that the IRS has blessed in several letter rulings back in 1993 and 1994 that is called the **401(k) switchback**. Getting a switchback program set up involves quite a bit of rigmarole, and I am not going to pretend that what follows is a perfect explanation of the technique.

In brief, under a suitable program, an ESOP participant is allowed to make an additional pre-tax deferral to the 401(k) plan equal to the amount of the ESOP dividends passed through to her or him. The plan sponsor then pays the ESOP dividends to the company payroll office, and there is a chain of paper that has established an agency relationship between the ESOP participant and the payroll office. [This is done by signing forms, etc. etc.].

If the ESOP participant elects the additional 401(k) deferral equal to her or his ESOP dividends, his or her paycheck would reflect the ESOP dividend amount and the additional pre-tax deferral to her or his 401(k) account. The paycheck has gone neither up or down for his or her personal tax situation.

Now an employee can elect not to make an additional 401(k) deferral, and thus have his or her dividend paid, and have personal tax liability on the amount.

As noted the IRS has held that the plan sponsor does not lose the ESOP dividend deduction in a switchback scheme as broadly outlined above if the dividends are first paid to the payroll office, and the employee has entered into a written agency agreement with the payroll office. I refer to Internal Revenue Private Letter Ruling 9321065.

One expert in designing these 401(k) Switchback programs writes,

> "Because the dividend pass-through/401(k) switchback feature involves a considerable amount of work to implement with regard to treasury and payroll procedures (including software programming changes), the company will want to carefully assess the anticipated value of the program both in terms of the expected dividend deduction and enhanced employee ownership values." Duncan E. Harwood, Arthur Anderson Consulting, LLP, "Dividend Pass-Through: Providing Flexibility", Proceedings Book, The 1995 Two Day ESOP Deal, Las Vegas, Nevada, page 158, The ESOP Association.

In short, Section 4 is in H.R. 1592 to simplify encouraging people to save their dividends paid on ESOP stock in a manner that encourages the corporation to pay dividends in an employee owner arrangement, compared to accomplishing the same thing in a convoluted way.

Now, lets turn to the third question set forth at the beginning of this statement. Please remember the answer to this question would go a long way in determining whether the Congress will want to make Section 4 law, or something like it..

The answer to this question should be self-evident. The current IRS position is anti-savings and anti-simple. To encourage saving the dividends on ESOPs in a tax-qualified ERSIA plan in a manner that is simple and easy to understand, Section 4 of H.R. 1592 should become law.

Otherwise, we can all accept the IRS position that in order to encourage the savings of the ESOP dividends the plan sponsor should engage in some mumbo-jumbo involving the payroll office being an agent for employees who just happen to figure out how to increase their 401(k) elective deferrals and who tell their "agent" to put their dividends in the 401(k) plan.

In conclusion Madam Chair, the ESOP and employee ownership community, in allegiance of sponsors of 401(k) plans and dividend reinvestment plans, believe that your focus on item 5 in your April 28th Subcommittee release will lead you and your colleagues to conclude that Congress should enact Section 4 of H.R. 1592, the ESOP Promotion Act of 1997.

And, let me pledge that the ESOP community will work with you, your colleagues, Committee staff, the staff of the Joint Tax Committee, and Treasury staff, to ensure that any legislative action on Section 4 meets its intent to be a fair and reasonable provision of law, both in terms of application and revenue impact, that promotes savings, and employee ownership.

Again, I thank you for your leadership in the area of pension law, and for the leadership of the Oversight Subcommittee of the Ways and Means Committee.

Statement of the Investment Company Institute
Submitted to the
Subcommittee on Oversight
Committee on Ways and Means
Hearing on Oversight of Pension Issues
May 19, 1998

The Investment Company Institute[1] is pleased to submit this statement to the Subcommittee on Oversight of the House Committee on Ways and Means to indicate our strong support for many of the provisions of H.R. 3788, the Retirement Security for the 21st Century Act. The Institute commends the sponsors of this bill, as well as other members of this subcommittee, for their interest in retirement savings policy. As discussed below, the Institute believes that H.R. 3788 makes enormous strides in addressing current issues involving retirement savings by making the retirement plan system more responsive to the needs of Americans.

Retirement savings is of vital importance to our nation's future. The challenge facing working Americans today is to ensure that they prepare adequately for their financial needs in retirement. This challenge is particularly pressing in light of two demographic events. First, members of the "Baby Boom" generation are rapidly approaching their retirement years. Evidence from recent studies strongly suggests that as a generation, they have not adequately saved for their retirement.[2] Second, Americans today are living longer. Taken together, these trends will place an enormous strain on the Social Security program in the near future.[3] In order to ensure that individuals have sufficient savings to support themselves in their retirement years, much of this savings will need to come from individual savings and employer-sponsored plans.

The mutual fund industry's primary focus is on saving and long-term investment. The Institute has long supported efforts to enhance the ability of individual Americans to save for retirement in individual-based programs, such as the Individual Retirement Account or IRA, and employer-sponsored plans, such as the popular 401(k) plan. In particular, we have urged that Congress: (1) create and maintain appropriate individual and employer incentives to save; (2) reduce unnecessary and cumbersome regulatory burdens that deter employers from offering retirement plans; and (3) keep the rules simple and easy to understand.

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[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,024 open-end investment companies ("mutual funds"), 438 closed-end investment companies and 9 sponsors of unit investment trusts. Its mutual fund members have assets of about $4.932 trillion, accounting for approximately 95% of total industry assets, and have over 62 million individual shareholders.

[2] The typical Baby Boomer household will need to save at a rate 3 times greater than current savings to meet its financial needs in retirement. Bernheim, Dr. Douglas B., "The Merrill Lynch Baby Boom Retirement Index" (1996).

[3] Social Security payroll tax revenues are expected to be exceeded by program expenditures beginning in 2013. By 2032, the Social Security trust funds will be depleted. *1998 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.*

It is our view that H.R. 3788 will make retirement plan rules more responsive to the needs of today's workforce and the savings patterns of most Americans, ease the administrative complexity that employers -- especially small employers -- confront when seeking to establish retirement plans, and create significant incentives for individuals to save for retirement in their employer-sponsored plans.

I. Incentives to Save for Retirement

In order to increase retirement savings at every level to meet the retirement needs of the future, Congress must provide working Americans with the incentive to save and the means to achieve adequate retirement security. The current tax law imposes numerous limitations on the ability of retirement plans to deliver benefits to individual workers. One way to ease these limitations is for Congress to update the rules governing contribution limits to employer-sponsored plans. Increasing these limits will facilitate greater retirement savings and help ensure that Americans will have adequate retirement income.

The Institute strongly supports the provisions contained in H.R. 3788 that would address these issues. Section 101 of the bill would increase 401(k) plan and 403(b) arrangement contribution limits to $15,000 from the current level of $10,000; government-sponsored 457 plan contribution limits would increase to $15,000 from the current level of $8,000. Section 101 would also modify the section 401(a)(17) limit on compensation that may be taken into account to determine benefits under qualified plans by reinstating the pre-1986 limit of $235,000, indexed in $5,000 increments. The current limit is $160,000. Another important provision is Section 202 of H.R. 3788, which would repeal the "25% of compensation" limitation on contributions to defined contribution plans. These limitations can prevent low and moderate income individuals from aggressively saving for retirement. (As is noted below, the repeal of these limitations is also necessary in order to enable many individuals to take advantage of the "catch-up" proposal in the bill.)

In addition, Congress should create saving incentives that accommodate today's work patterns. On average, individuals change jobs once every five years. Current rules restrict the ability of workers to roll over their retirement account from their old employer to their new employer. For example, an employee in a 401(k) plan who changes jobs to work for a state or local government may not currently take his or her 401(k) balance and deposit it into the state or local government's pension plan. Thus, the Institute strongly supports Sections 301 & 302 of H.R. 3788, which would enhance the ability of American workers to take their retirement plan assets to their new employer when they change jobs by facilitating the portability of benefits among 401(k) plans, 403(b) arrangements, 457 state and local government plans and IRAs.

Finally, the laws governing pension plans must be flexible enough to permit working Americans to make additional retirement contributions when they can afford it. Individuals, particularly women, may leave the workforce for extended periods to raise children. In addition, many Americans are able to save for retirement only after they have purchased their home, raised children and paid for their own and their children's college education. Section 201 of H.R. 3788 addresses these concerns by permitting additional salary reduction "catch-up" contributions. The catch-up proposal would permit individuals at age 50 to save an additional $5,000 annually on a tax-deferred basis. The idea is to let individuals who may have been

unable to save aggressively during their early working years to "catch up" for lost time during their remaining working years. Section 202's repeal of the "25% of compensation" limit could further enhance the ability of Americans to "catch-up" on their retirement savings.

II. Reduction of Regulatory Burdens

The current regulatory structure contains many complicated and overlapping administrative and testing requirements that serve as a disincentive to employers to sponsor retirement plans for their workers. Easing these burdens will promote greater retirement plan coverage and result in increased retirement savings.

The Institute believes that any meaningful pension reform legislation must focus on increasing pension plan coverage within the small business market. Small business represents the fastest growing employer sector in the economy today. Millions of Americans are employed by small businesses and it is imperative that Congress provide incentives to small businesses to sponsor pension plans for their workers. In general, ***under 20 percent*** of employers with less than 100 employees provide a retirement plan for their employees, as compared to about 84 percent of employers with 100 or more employees.[4] The complexity of our pension system's rules and regulations and the high administrative costs associated with pension plans act as barriers to small employers from establishing a retirement plan for their workers. As a result, millions of Americans are denied the ability to save adequately for their retirement.

The Institute strongly supports expanding current retirement plans targeted at small employers. Specifically, the Institute supports expansion of the SIMPLE plan, which was instituted in 1997 and offers small employers a truly simple, easy-to-administer retirement plan. The response from the small employer market for the SIMPLE has been overwhelming. The Institute estimates that as of July 31, 1997, after only seven months of availability, its members were custodians for an estimated 95,000 SIMPLE IRA accounts. The SIMPLE program is especially popular among the smallest employers -- those with under 25 employees. Indeed, the vast majority of employers establishing these plans have under 10 employees. Our industry has found that small employers welcome the opportunity to sponsor a retirement plan for their workers that is low on administrative burdens and cost.

H.R. 3788 addresses these barriers to small business plan coverage -- regulatory complexity and cost. For example, Section 104 of H.R. 3788 would modify the top-heavy rules.[5] This rule, which was intended to assure that employer-sponsored plans equitably delivered benefits to the entire workforce and not just to business owners and key management personnel, is both costly and, in the context of 401(k) plans, completely unnecessary. A 1996 U.S. Chamber of Commerce survey found that the top-heavy rule is the most significant

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[4] *EBRI Databook on Employee Benefits (4th edition),* Employee Benefit Research Institute (1997).

[5] The top-heavy rule is set forth at Section 416 of the Internal Revenue Code. The top-heavy rule looks at the total pool of assets in a plan to determine if too high a percentage (more than 60 percent) of those assets represent benefits for "key" employees. If so, the employer is required to (1) increase the benefits paid to non-key employees, and (2) accelerate the plan's vesting schedule.

regulatory impediment to small businesses establishing a retirement plan.[6] The rule imposes significant compliance costs and is particularly costly to small employers, which are more likely to be subject to the rule. It is also unnecessary because other tax code provisions address the same concerns and provide similar protections. We believe that Section 104 of the bill will substantially reduce the costs and burdens that prevent small employers from establishing plans. Section 101 would also benefit small businesses and their employees by increasing the contribution limits to SIMPLE plans from $6,000 to $10,000. H.R. 3788 also contains a provision (Section 103) that would establish a "salary reduction only SIMPLE." We recommend that the Congress allow more time for the development and growth of the employer contribution SIMPLE plans before creating a new type of SIMPLE plan in which the employer makes no contribution.

III. Simplification of Rules

Confusing rules make it difficult for individuals to manage their retirement assets; as a result, they are less likely to participate in retirement programs. An example of this are the rule changes associated with the IRA. When Congress introduced universal deductions for IRAs in 1982, IRA contributions skyrocketed, rising from less than $4 billion in 1980 to approximately $38 billion in both 1985 and 1986. At the IRA's peak in 1986, about 29% of all families with a head of household under age 65 had IRA accounts. These were not mainly high-income families. In 1986, 75% of all IRA contributions were from families with annual incomes less than $50,000.[7] Moreover, the median income of those making IRA contributions (expressed in 1984 dollars) dropped by 24 percent, from over $41,000 in 1982 to below $29,000 in 1986.[8] The program was, indeed, primarily used by middle-class Americans.

When Congress restricted the deductibility of IRA contributions in the Tax Reform Act of 1986, the level of IRA contributions fell sharply and never recovered -- to $15 billion in 1987 and $8.4 billion in 1995.[9] While many families no longer are able to deduct their IRA contributions as a result of the 1986 restrictions, they still may take advantage of the tax deferral for earnings on non-deductible IRA contributions. This incentive, however, has proved insufficient to induce continued participation in the IRA program. Moreover, among families retaining eligibility to fully deduct IRA contributions, IRA participation declined on average by 40% between 1986 and 1987, despite the fact that the change in law did not affect them.[10]

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[6] *Federal Regulation and Its Effect on Business--A Survey of Business by the U.S. Chamber of Commerce About Federal Labor, Employee Benefits, Environmental and Natural Resource Regulations*, U.S. Chamber of Commerce, June 25, 1996.

[7] Venti, Steven F., "Promoting Savings for Retirement Security," Testimony prepared for the Senate Finance Subcommittee on Deficits, Debt Management and Long-Term Growth (December 7, 1994).

[8] Hubbard, R. Glenn and Skinner, Jonathan, "The Effectiveness of Savings Incentives: A Review of the Evidence" (January 19, 1995).

[9] Internal Revenue Service, Statistics of Income.

[10] Venti, supra at note 7.

Indeed, fund group surveys show that even more than a decade later, individuals do not understand the eligibility criteria. American Century Investments surveyed 534 "savers" with respect to the rules governing IRAs. The survey found that "changes in eligibility, contribution levels and tax deductibility have left a majority of retirement investors confused."[11] This confusion is an important reason behind the decline in contributions to IRAs.

H.R. 3788 recognizes the need to keep the rules simple in the case of both IRAs and employer-sponsored plans. Section 205 of the bill would simplify the required minimum distribution rules applicable to distributions from qualified plans and IRAs. The bill would raise the minimum distribution age to 75 from 70 1/2. In addition, the first $300,000 of assets in plans and IRAs would be exempt from the rule. This proposal recognizes that individuals live and work longer. In addition, it provides individuals with smaller account balances with relief from a complex and burdensome rule. Further, the changes to the contribution limits for various types of plans under Section 101 of the bill would result in consistent rules for 401(k), 403(b) and 457 plans. This, in turn, will make the pension system less confusing to plan participants and should result in greater plan participation.

IV. Conclusion

Today's employer-sponsored retirement plan system has evolved into a complex array of burdensome administrative requirements and restrictive limitations that can serve as barriers to plan formation. Simplification of the rules applicable to employer-sponsored plans and individual retirement savings would result in a greater number of employer-sponsored plans, a higher rate of worker coverage by a pension plan and more opportunities for Americans to save effectively for retirement. The Institute strongly supports the provisions described above and commends the sponsors of H.R. 3788 for supporting reforms of the pension system that will increase plan coverage and encourage Americans to save for their retirement. In our view, passing this legislation is very important.

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[11] American Century Investments asked survey participants, who were self-described "savers," ten general questions regarding IRAs. One-half of them did not understand the current income limitation rules or the interplay of other retirement vehicles with IRA eligibility. "American Century Discovers IRA Confusion," Investor Business Daily (March 17, 1997). Similarly, even expansive changes in IRA eligibility rules, when approached in piecemeal fashion, require a threshold public education effort and often generate confusion. See, e.g., Crenshaw, Albert B., "A Taxing Set of New Rules Covers IRA Contributions," The Washington Post (March 16, 1997) (describing 1996 legislation enabling non-working spouses to contribute $2,000 to an IRA beginning in tax year 1997).

NCCMP

National Coordinating Committee for Multiemployer Plans

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May 21, 1998

The Honorable Nancy Johnson
Chair
Oversight Committee of the
Committee on Ways and Means
United States House of Representatives
343 Cannon House Office Building
Washington, D. C. 20515-0706

Dear Representative Johnson:

Enclosed for inclusion in the record of the May 5, hearing before the Committee on Ways and Means Subcommittee on Oversight on pension issues is testimony of the National Coordinating Committee for Multiemployer Plans ("NCCMP").

The NCCMP urges enactment of H.R. 3632, which would exempt multiemployer plan participants from the 100-percent-of-compensation and early retirement dollar limit reduction rules in Section 415 of the Internal Revenue Code. These rules are forcing reductions in the hard-earned benefits of rank-and-file workers covered by multiemployer pension plans.

My professional staff is available to provide additional information or answer any questions you may have.

With kind personal regards, I am

Sincerely,

Bob Georgine

Robert A. Georgine
Chairman

enclosure

NCCMP

National Coordinating Committee for Multiemployer Plans

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TESTIMONY OF THE
NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS
BEFORE THE
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
ON PENSION ISSUES

May 5, 1998

The National Coordinating Committee for Multiemployer Plans ("NCCMP") submits these comments in support of H.R. 3632, which would eliminate the rules in Section 415 of the Internal Revenue Code that are forcing reductions in the benefits of workers covered by multiemployer pension plans.

The NCCMP is the only national organization devoted exclusively to protecting the interests of the more than nine million workers, retirees, and their families who rely on multiemployer plans for retirement, health and other benefits. The NCCMP's purpose is to assure an environment in which multiemployer plans can continue their vital role in providing benefits to working men and women. The more than 240 Affiliate and Associate Affiliate members of the NCCMP encompass plans and plan sponsors in every major segment of the multiemployer plan universe. The NCCMP is a nonprofit organization.

To understand why multiemployer plans and their participants need the relief provided in H.R. 3632, it is important for you to understand the basic characteristics of these plans. Therefore, these comments first describe the unique characteristics of multiemployer plans and then describe the need for relief from the Code section 415 limitations.

I. CHARACTERISTICS OF MULTIEMPLOYER PLANS

Multiemployer plans are common in industries characterized by many small employers and highly volatile employment patterns, such as the construction trades, garment, trucking, longshore, entertainment, etc. Often participants in these plans will work for only a brief period for any one contributing employer, and work for numerous employers each year.

Multiemployer plans add up these periods of service for eligibility, vesting and benefit accruals. They provide two elements for their participants and contributing employers that all observers agree are sorely needed in the pension system generally to make it feasible for small employers to provide pensions -- full portability for mobile workers and efficiencies and economies of scale in plan administration.

Multiemployer plans are funded based on contribution rates fixed in collective bargaining agreements that typically run for a period of at least three years. These agreements require employers to contribute a set dollar amount per hour worked, or other measure of service or unit of production, for each employee covered by the bargaining agreement. The total contributions to the plan therefore fluctuate based on increases and decreases in covered work in the industry.

Employee representatives typically negotiate a dollar per hour labor cost with employers. The hourly dollar amount of current wages is generally this total labor cost, reduced by the amount of plan contributions. Thus, as a practical matter, employees are making benefits contributions out of their current hourly wages.

Multiemployer pension plans typically provide either flat dollar benefits or benefits equal to a dollar amount times years of service. Unlike the standard for single-employer plans, multiemployer plan benefit formulas are rarely based on a participant's compensation.

Favorable investment experience over the past decade, plus the parties' commitment to maintain steady funding for pension, has allowed many plans to increase benefits in recent years. These increases have usually taken the form of higher normal retirement benefit levels. In addition, some plans have reduced the amount of covered service needed during a year to earn a benefit credit.

II. THE NEED FOR MULTIEMPLOYER PLAN RELIEF FROM PROVISIONS OF TAX CODE SECTION 415

Largely because of these unique characteristics, multiemployer plans need relief from certain provisions that were never intended to have the effect they have on such plans.

A. Exemption from Code section 415 100 Percent of Compensation Limit

H.R. 3632 provides a much needed multiemployer plan exemption from the provision of Code section 415 that limits the benefits that can be paid under a pension plan to 100 percent of the participant's average compensation for the three consecutive calendar years in which it was the highest.

The Code section 415 limits are designed to prevent highly compensated individuals from using pension plans as tax avoidance schemes to defer excessive pension benefits. This does not happen in the context of multiemployer plans.

However, due to the unusual structure of multiemployer plans, the work patterns of their participants and the manner in which the contribution streams that fund them are negotiated, they face a risk of running afoul of the 100 percent of compensation limit. Where this happens, the participants who are hurt by the limit are the lowest paid rank and file workers covered under the plan -- the exact opposite of the type of participants these rules were designed to impact.

As discussed above, multiemployer plans typically provide the same annual retirement benefit to a participant or to all participants who have the same number of years of service. It is extremely rare for a multiemployer plan benefit formula to be based on compensation. Multiemployer plan benefit formulas are therefore very advantageous to lower paid workers. As a percentage of compensation, the more money a participant makes the smaller is his benefit. The effect of these formulas is to provide an adequate retirement benefit even to the lowest paid of these workers, by, in effect, subsidizing such benefit by providing relatively lower benefits to the higher paid workers.

Ironically, it is this very antidiscriminatory aspect of multiemployer plans that creates much of their problem under the 100 percent of compensation limit. The level of plan benefits is set by the trustees with one eye towards what the contribution stream funding the plan can support and the other eye towards the reasonable retirement needs and expectations of the average plan participant. This benefit may, however, be higher than the 100 percent of compensation limit for plan participants who were paid significantly less than the norm.

Another problem is created by the work patterns of many multiemployer plan participants. In a typical single employer plan, a plan participant is employed continuously with the same employer during his period of participation in the plan. Over time, due to inflation, that participant's compensation will increase. Because this employment is continuous, the three consecutive years in which compensation is the highest -- that is, the three years on the basis of which the 100 percent of compensation limit is computed -- will typically be the last three years. Thus, in effect, single employer plan participants get the benefit of cost of living adjustments to their 100 percent limit while they are working, because they get the full advantage of their compensation increases due to their continuous employment. Once they leave service, their 100 percent limit is also directly adjusted annually under section 415(d) to reflect increases in the cost of living.

In the context of multiemployer plans, the 100 percent of compensation limit sometimes shrinks, despite cost of living increases in pay rates. As multiemployer plan participants grow older, they may find it more difficult to secure continuous employment. The gaps between their periods of employment may become more frequent and more prolonged. This is especially true in industries characterized by hard, physical work, especially outdoors, or work in extreme climates. Even though the hourly rate may reflect inflation, a reduced number of hours worked during some portion of any period of three consecutive years may prevent that period from being used as the base for computing the 100 percent limit. If an earlier group of three years is used, the worker is deprived of the automatic inflation adjustment to this limit that the typical single employer plan participant would obtain through a salary increase. In addition, because the participant has not yet retired, no direct inflation adjustment to the limit is allowed. This shrinking of the limit is particularly pronounced in declining industries where work has become more scarce in general.

Plan trustees recognize that multiemployer pension benefits have, in effect, been paid for by the plan participants. In some declining industries, to prevent participants from losing their benefits due to inability to find continuous employment, trustees have reduced the number of hours per year necessary to earn a pension credit. For some participants this can increase the severity of the impact of the 100 percent of compensation limit, as their actual

pay may decline -- even if hourly wage rates go up -- because they are working fewer hours. Although it looks as though they are earning additional pension benefits, these participants hit the 100 percent limit and lose their pension benefits anyway.

It is important to note that it is not possible to adjust plan contributions to deal with this problem. Multiemployer plan contribution rates are set through collective bargaining. The rate set for any particular collective bargaining unit is uniform, typically because the hourly wage package is uniform. There is no practical way to provide different contribution rates for different workers depending on the number of hours they work, even if it were possible to know or to predict the number of hours a particular worker would work during a particular year. Contributions can only be reduced across the board, and if they are, wages or other benefit plan contributions would need to be increased across the board to maintain the equilibrium and follow through on the bargained-for compensation. So the majority would be denied an adequate pension to avoid having the pension of the lowest-paid among them exceed the 415 limits.

Ironically, the 100 percent of compensation limit is not a problem for highly compensated employees generally. Employers maintaining single employer plans typically provide benefits in excess of the Code section 415 limits for highly compensated employees through unfunded excess benefit plans. This is not a feasible solution in the context of multiemployer plans. The Taft-Hartley Act requires multiemployer plan benefits to be provided through a trust.

To understand the harshness of the impact of the 100 percent limit on plan participants, it is important to note that, from the worker's perspective, this limit is imposed retroactively. Plan participants ordinarily compute their benefits using the formulas they find in the summary plan descriptions and with reference to their years of service. They make plans for retirement based on the benefits so computed. They usually do not realize the amount of reduction in their benefit that will be made due to the 100 percent limit until they actually retire and make a claim for benefits.

We therefore urge you to exempt multiemployer plans from the 100 percent of compensation limit.

B. Exemption from Code section 415 Reductions in Pension Benefits on Early Retirement

H.R. 3632 would provide for multiemployer plans the same section 415 dollar limit for early retirement benefits that applies to tax-exempt entity and government employees.

Code section 415(d) imposes a dollar limit on the annual benefit that may be paid from a defined benefit plan. This dollar limit is $90,000, indexed for inflation. This amount is far higher than the typical multiemployer plan benefit and is ordinarily not a problem for multiemployer plans.

However, the dollar amount is reduced actuarially for benefits that start earlier than normal retirement age. This actuarial reduction can have a severe impact on early retirement benefits.

Many multiemployer plans provide pensions that can be taken on an unreduced basis after a certain number of years of service, e.g., 30. These are referred to, for example, as "30 and out pensions" or "service pensions." In industries that involve hard, physical labor, it is often not feasible for participants to work past their early or mid-50s. For someone who has been working at these backbreaking jobs since high school, "early" retirement represents a well-earned chance to stop working so hard. These special service pensions are reasonably designed to address the income needs of such workers. Yet the section 415 dollar limit could restrict such workers to receiving little more than $40,000 or so a year.

To prevent this dollar limitation from becoming so low that it interferes with the ability of multiemployer plans to provide adequate retirement benefits to early retirees, H.R. 3632 would allow multiemployer plans to use the same rule that is currently available to plans maintained by government and tax exempt organizations. This rule is found in Code section 415(b)(F) and is the rule that was in place before the Tax Reform Act of 1986. Under this rule, the dollar limit will be reduced only below age 62 and will not be reduced below a dollar amount that is the actuarial equivalent of a $75,000, indexed, limitation at age 55.

* * * * *

We appreciate this opportunity to provide testimony on H.R. 3632 and the need for relief for multiemployer plan participants from the Code section 415 rules. We would be pleased to provide additional information at the Committee's request.

Statement for the Written Record of
the Subcommittee on Oversight of
the House Ways and Means Committee

Hearing on Pension Issues
May 5, 1998

submitted by

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The National Defined Contribution Council ("NDCC") is pleased to submit this written statement for the record. We wish to commend the Committee and Representatives Johnson, Portman, and Cardin for their continuing attention to the importance of encouraging more retirement savings, and their willingness to consider reforms which would lead in that direction.

The NDCC is the leading trade organization in the defined contribution industry representing plan providers which has legislative and regulatory advocacy as its primary objective. Its membership is comprised of plan providers with representatives from investment management firms, banks, brokerage firms, insurance companies and consulting firms, as well as those who support the industry as third party administrators, attorneys, and CPAs.

We wish to submit our comments on the following:

1. Increasing Retirement Savings.

- *Simplify duplicative limitations; increase threshold levels.*

The duplicative limitations on retirement savings need to be simplified. Currently, contributions to a defined contribution (e.g., §401(k)) plan are limited to the lesser of 25% of compensation or $30,000, elective deferrals are limited to $10,000, contributions for certain employees is further limited by the top-heavy rules, and the definition of includible "compensation" has been artificially lowered to $160,000.

We propose the following:

- increase the $30,000 limit to $50,000.
- repeal the Clinton tax increase which lowered the compensation limit (and restore that limit to the level at which it would have been absent the tax increase).
- repeal the duplicative top-heavy rules.

- *Married Couples / One Wage Earner.*

The Small Business Job Protection Act of 1996 and the Taxpayer Relief Act of 1997 took a step in the right direction by providing for spousal IRAs and by allowing homemaker spouses full contribution to an IRA even if the other spouse is an active participant in an employer-sponsored plan. However, homemakers deserve more than that -- contributions to IRAs are limited to $2,000, which affords very little opportunity for them to amass sufficient savings on which to retire.

We propose the following:

- Creation of a "Spousal §401(k) Account," under which nonworking spouses can contribute up to the full §401(k) limit each year, thus creating parity of savings ability between working and homemaking spouses.
- Alternatively, double the §401(k) savings limit for participants with homemaker spouses, to allow the "family" savings account to grow to accommodate the savings needs of both spouses.

- Increase savings limits (both §401(k) and 25% of compensation limits) to allow a "catch-up" for individuals returning to the workplace -- allow a 5-year "catch up" of contributions not made while an individual was out of work. Allows retirement savings by homemakers, as well as providing incentive for temporarily unemployed to return to the workforce.

2. Simplification.

The §401(k) plan has been the great success story of the retirement savings world in the past decade. However, the nondiscrimination rules are burdensome and complicated, and increase the cost of maintaining §401(k) plans, particularly for small employers. In addition, the "top-heavy" rules are burdensome, complex, and duplicate existing nondiscrimination rules, providing a substantial disincentive for small employers to adopt qualified plans. The required minimum distribution rules, which require annual actuarial computations for certain employees over age 70½, are administratively burdensome and confusing to the average participant.

Congress should create incentives for more employers to create §401(k) and other employer-sponsored plans through further simplification.

We propose the following:

- Eliminate the §401(m) ("ACP") test if the employer's matching contribution is uniform, bottom-weighted, or meets the §401(a)(4) nondiscrimination test.
- Maintain only the "2-times" test under §401(k).
- Change the 2½ month deadline for returns of excess contributions prior to the end of the next plan year.
- Repeal the duplicative top heavy rules.
- Eliminate the required minimum distributions.
- Adopt a consistent definition of "compensation" as it affects all retirement plans (e.g., for purposes of §§404, 415, "highly compensated employees" definition, and ADP testing purposes).
- Apply the §401(k) contribution limits (currently $10,000) to all salary deferral plans.
- Allow for electronic delivery of consents and notices by plan sponsors (e.g., §402(f) notices).

3. Portability.

America's workforce is increasingly mobile, and the employee who stays with one employer for his or her entire career is now almost unheard of. It is also very common for an individual to work alternately in the private and public sector. However, due to current restrictions in the Internal Revenue Code, the retirement plans offered in the public sector (§403(b) and §457 plans) cannot currently be rolled into retirement plans maintained by private sector plans (e.g., §401(k) plans), and the reverse is true if an employer moves from private to public sector. Accordingly, many workers have their retirement savings fragmented between several accounts, often left behind with a former employer.

We propose the following:

- We endorse the pension portability proposals set forth in H.R. 3503 (the "Retirement Account Portability (RAP) Act") and H.R. 3788, (the Portman/Cardin "Retirement Security for the Twenty-First Century Act").
- In particular, workers should be able to freely roll their retirement savings between all forms of employer-sponsored plans (§457, §403(b) and §401(k) plans), and certain types of IRAs when they switch jobs.
- The IRS should be given discretion to allow for rollovers past the 60-day period, in cases where reasonable cause is shown for the delay.

4. Conclusion.

We wish to thank the Committee for the opportunity to provide our views on these important matters. Pension reform may not be the most glamorous issue before Congress, but we applaud the Committee and the members involved for continuing to devote much-needed attention to the retirement savings of all Americans. The NDCC stands ready to assist the Committee on these important issues.