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PENSION REFORM

HEARING

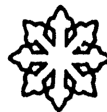
BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

JUNE 30, 1999



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PENSION REFORM

WEDNESDAY, JUNE 30, 1999

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:00 a.m., in room SD–215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Chafee, Moynihan, Baucus, Conrad, Graham, and Kerrey.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please be in order.

Today we will hear testimony about legislative proposals concerning pension plans. I have been a proponent of personal savings for retirement and have introduced, along with my friend, the Senator from Montana, Max Baucus, the Retirement Savings Opportunity Act, which will help expand retirement savings opportunities for working Americans.

Others on the committee have made pension reform a priority. Senators Grassley and Graham have been leaders in this area, supported by Senators Jeffords, Baucus, Hatch, Breaux, Kerrey, Mack, Robb, Chafee, Thompson, and Murkowski. They have introduced the Pension Coverage and Portability Act.

Senator Moynihan has been active in this area too, with his Pension Right-to-Know Act, co-sponsored by Senators Kerrey, Robb, and Chafee.

We will also be hearing today from our friend, Senator Tom Harkin, who will be introducing legislation soon on Cash Balance Plans.

We should all be concerned about the lack of pension coverage in this country. According to the Bureau of Labor Statistics, 78 percent of employees of large- and medium-sized employers are eligible for an employer-sponsored plan, and only 48 percent of individuals who work in small business establishments are eligible for any retirement plan in 1994.

We know that the number of defined benefit plans has been decreasing, from 59 percent in 1991 to 50 percent in 1997. Clearly, there is a need to do something to promote the employer's system. We will hear testimony today from many who sponsor and administer retirement plans on how the proposed legislation will do that.

In addition, we will hear testimony about a new type of plan, the cash balance plan. While there are fewer defined benefit plans, more and more employers are considering switching from their traditional defined benefit plan to cash balance.

Younger employees like these new plans, since these plans reflect the reality of a mobile work force, for less than 10 percent stay with one employer for more than 20 years.

Older, long-service employees are not happy with this switch. The reason for their unhappiness is the older workers' reliance on these pension benefits, which were heavily weighted towards employees who stayed with the employer until retirement.

Senator Moynihan's bill would add disclosure requirements when employers amend their plans, so employees would know what they are getting under a new plan. Employers, however, are worried that extensive disclosure and the attendant administrative burdens would impede employers from joining the only defined benefit plan that is growing in popularity. This hearing will examine the many sides of this important issue.

I would now like to welcome you, Senator Harkin, and would be pleased to hear your testimony.

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA

Senator HARKIN. Mr. Chairman, thank you very much for this opportunity. I will be very brief and to the point. I really agree with what you said in your opening statement about the importance of pensions in our society today.

Mr. Chairman, older workers across America have been paying into pension plans throughout their working years, along with the companies they work for, anticipating a secure retirement. Now, as more Americans than ever before in history approach retirement, we are seeing a disturbing trend by employers to cut their pension benefits.

Mr. Chairman, what companies are doing now in switching from the defined benefit plan to the cash plan, I believe, is a scam of immense proportions and it is taking money, literally, out of the pockets of older workers.

They are changing to these so-called cash benefit plans and they are taking the money out and using the money for other purposes. It allows the companies to profit at the expense of their older workers.

Let me just say that employees generally receive three types of benefits for working. You get direct wages, health benefits, and pensions. Reducing an employee's pension years after it is earned should be no more legal than denying a worker wages after work has been done.

Our laws appear to have that requirement, but, with the creation of these cash benefit plans, I think we are seeing the spirit of the law, if not the law itself, violated.

Under traditional defined benefit plans, we know the worker gets a pension based on length of employment and the average pay for the last few years of service. It is based on a preset formula using those key factors rather than an amount in an account.

But, under a cash balance plan, the worker gets a pension based on the sum placed into an employee's account, and that sum is based on wages or salary paid.

Now, what happens, is that when they switch from a defined benefit plan to a cash balance plan, older workers are discriminated against. While they are working under these new cash balance plans, they see no benefits added to their pensions for a number of years. This is called the "wear-aways."

I wondered what they meant by wear away. Well, it wears away over five, six, or 7 years. I kind of call it a plateau. They go up, they reach a plateau and they level off, then they start to get back in to the cash balance plan. Well, it is that gap that allows these companies to take millions of dollars out of their pension programs and use it for other things.

So it is a plateau, and I believe it is a type of age discrimination, pure and simple. After all, a new employee, usually younger, would effectively be receiving greater pay for the same work, the money put into his pension plan.

So what does it mean to real people? I know it gets kind of foggy when you start talking about these things. Two Chase Manhattan banking executives hired an actuary to calculate their future pensions after Chase Manhattan's predecessor, Chemical Bank, converted to the cash balance plan.

The actuary estimated that their future pensions had fallen 45 percent. John Healy, one of the executives, says, "I would have had to work about 10 more years before I even broke even."

Ispat Inland, Inc., an East Chicago steel company, converted to a cash balance plan January 1 this year. Paul Schroeder, a 44-year old engineer who had worked for them for 19 years, calculated it could take him as long as 13 years to acquire additional benefits.

So to provide for some fairness, I introduced S. 1300, the Older Workers Pension Protection Act of 1999, which prohibits the practice of wear away. It would not have that plateau. It provides that a company cannot discriminate against long-time workers by not putting aside money into their pension account just because pension benefits were earned under the old plan.

Under my bill, there would be no wear away, no plateau in which a worker would be receiving no increases in pension benefits while working while other employees, in fact, receive benefits.

So I am urging you, Mr. Chairman and this committee, to eliminate the unfair practice of what they call wear away that discriminates against older workers.

You mentioned, Mr. Chairman, Senator Moynihan's bill, S. 659, that requires that individuals receive clear, individualized notice when they convert from one plan to another. I support that. There is no doubt that putting the light on it would help immensely.

But I would just go further. Notice can be given, but if you are 45 or 50 years old, what are you going to do, quit and walk off to another job? Maybe yes, but maybe, really because of your circumstances, family, and housing, and kids in school, you cannot do that. So you are kind of stuck there. Yet, you are on that plateau, you are in that wear away.

So, while I support giving notice, I really hopefully and respectfully urge this committee to really prohibit this discrimination and

to just prohibit them from having that plateau, having that wear away, and letting those accrued benefits continue on, even if they do switch to a cash balance plan.

I thank you very much, Mr. Chairman.

[The prepared statement of Senator Harkin appears in the appendix.]

The CHAIRMAN. Thank you, Senator Harkin. We appreciate your being here.

We will now proceed to hear from three individuals to discuss the so-called new pension plan vehicle known as the cash balance plan and the appropriate disclosure that should be given participants where an employer changes from a traditional defined benefit pension plan to a cash balance plan.

First, we will hear from Mr. Patrick Purcell from the Congressional Research Service, who will explain the cash balance plan issues. Next, on behalf of the Association of Private Pension and Welfare Plans, is Rita D. Metras, director of Total Compensation at Eastman Kodak. Then we will hear from Robert Hill, a Denver trial lawyer who represents employees who have sued employers after they switched to a cash balance plan.

It is a pleasure to welcome all three of you. We will start with you, Mr. Purcell.

STATEMENT OF PATRICK J. PURCELL, SPECIALIST IN SOCIAL LEGISLATION, DOMESTIC SOCIAL POLICY DIVISION, CONGRESSIONAL RESEARCH SERVICE, WASHINGTON, DC

Mr. PURCELL. Chairman Roth, members of the committee, good morning and thank you for inviting me to today's hearing on pension reform and the conversion of traditional defined benefit pensions into another kind of a pension called a cash balance plan.

In the next few minutes, I would like to set the ground work for the later two witnesses by explaining what a cash balance plan is and describing some of the issues that arise when an employer converts a traditional defined benefit pension into a cash balance plan.

First, what is a cash balance plan? Let me start by describing what we sometimes refer to as a traditional defined benefit pension. Typically, a defined benefit pension pays a worker a lifelong annuity based on years of service and final average pay.

For example, a worker with 30 years of service might qualify for a pension equal to 50 percent of average pay during the last 5 years before retirement. Another aspect of defined benefit pensions is that they are insured by the Pension Benefit Guarantee Corporation. These contrast with defined contribution plans such as those authorized under Section 401(k) of the Tax Code.

A defined contribution plan is much like a savings account in which money set aside by the employer and employees grows on a tax-deferred basis throughout the worker's career.

The retirement benefit from a defined contribution plan depends on the value of the account when the employee reaches retirement age. This can usually be taken as a lump sum, in a series of fixed payments, or it can be converted to a lifetime annuity.

A cash balance plan is a defined benefit plan in which the retirement benefit is defined as an account balance rather than as an annuity beginning at retirement. The employer establishes what

looks like individual accounts for each employee and attributes a percentage of pay to each account.

In addition, the employer credits interest to the account based on an interest rate that the employer chooses. Typically, employees who leave for another job are given the option of taking their accrued benefit in the form of a lump sum distribution.

With individual account balances, employer contributions based on a percentage of pay, and the option to take a lump sum distribution, a cash balance plan looks a lot like a defined contribution plan, such as a 401(k). Legally, however, it is not.

The legal distinction between a defined benefit plan and a defined contribution plan lies not in the way the benefit is described, either as an annuity beginning at retirement or as an account balance, but in who owns the plan's assets, the sponsor or the participants.

Under Federal law, a pension plan that does not consist of employee-owned individual accounts is a defined benefit plan. The accounts attributed to participants in a cash balance plan are merely hypothetical. They are devices for determining the value of an employee's accrued benefit. They are not employee-owned individual accounts, as they would be in a 401(k).

Why would a firm convert a traditional defined benefit plan to a cash balance plan? Two possible reasons, are to save money or to restructure the pension into something that is more appealing to younger workers, or both. Not all conversions to cash balance plans are intended to save money, and not all of them do.

However, if an employer wants to save money when converting to a cash balance plan, it can do so by setting a low starting account balance which temporarily delays new benefits from accruing—this is the period that Senator Harkin referred to as wear away—or by setting pay and interest credits at levels that reduce these expenses below the cost of funding a traditional pension.

The employer's total pension cost would also depend on the cost of any transition benefits provided to employees who have long periods of service under the traditional plan.

While cutting costs may be a priority for some employers who switch to a cash balance plan, for others the main objective is to provide retirement benefits that younger employees will understand and appreciate.

Traditional defined benefit pensions have been losing favor with employers for some time. As Chairman Roth noted in his opening remarks, according to the Department of Labor, coverage by defined benefit pensions in firms with 100 or more workers fell from 59 percent of employees in 1991 to 50 percent in 1997.

At the same time, the percentage of workers and firms of this size participating in defined contribution plans rose from 48 percent to 57 percent. For employers, part of the appeal of a cash balance plan is that it can be described to employees as something that looks like a defined contribution plan.

So why do employers just not close down their defined benefit pensions and replace them with defined contribution plans? The answer, in many cases, is that pension plan terminations are difficult to administer and can require a large expenditure of assets

over a short period of time. Conversion to a cash balance plan, on the other hand, requires only amending the existing plan.

For employees, conversion to a cash balance plan can have a substantial impact on future benefits. Traditional defined benefit pensions are typically based on final average pay, and a large part of the benefit is accrued in the last few years before retirement. Benefits in a cash balance plan are based on career average pay and, therefore, build up more evenly over time.

Workers converted to a cash balance plan at mid-career do not experience the build-up of benefits as they near retirement that would have occurred under a traditional plan. In some conversions, employers have set the starting balance at less than the value of benefits the employee had earned under the old plan, the so-called wear away period.

As long as departing employees are paid the greater of these two amounts, what they had accrued under the old plan, or what their account balance is under the cash balance plan, this practice is permitted, because for the employees who remain, the effect is a suspension of benefit growth rather than a reduction, which is permitted under ERISA.

The rate of interest in employer credits to cash balance plans also has a great impact on future benefits. Many employers peg these interest credits to the rate on 1-year Treasury bills or 30-year Treasury bonds. Although these rates are low compared to long-run returns in the stock market, employers guarantee the rate of return even if the actual return is lower.

Finally, setting the value of a lump sum distribution from a cash balance plan is a complex process that has led to several lawsuits. While it may seem odd that there would be controversy about the value of a lump sum distribution from a pension plan that describes its benefits in terms of an account balance, the guidance on this point issued by the Treasury Department has been a source of contention among interested parties.

This concludes my remarks, Mr. Chairman. I would be happy to answer any questions from the committee.

[The prepared statement of Mr. Purcell appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Purcell.

Ms. Metras, please.

STATEMENT OF RITA D. METRAS, DIRECTOR, TOTAL COMPENSATION, EASTMAN KODAK COMPANY, ROCHESTER, NY, ON BEHALF OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS (APPWP)

Ms. METRAS. Good morning. I am Rita Metras, director of Total Compensation at Eastman Kodak Company. Kodak provides qualified retirement benefits for our employees who live in almost every State. I am here today as a representative of the APPWP, the benefits association.

First of all, I would like to thank you, Mr. Chairman, for holding this hearing and for the interest you, Senator Moynihan, and the other members of the committee have shown in the important issues surrounding cash balance plans.

Kodak is changing its traditional retirement plan to a cash balance plan with a 401(k) company match. Current employees can

elect to remain in the current plan or go to the new one. Like many other American corporations, Kodak changed its retirement program to attract and retain the type of workers it needs to succeed.

Unfortunately, few candidates for employment appreciate the value of a defined benefit plan, and many favor the 401(k) and stock plans our competitors offer. With their account design, cash balance plans are attractive to employees. They are easier to understand and communicate, and employees like their portability and steady accrual pattern. Already, this change has made the difference between employees accepting our offers of employment or choosing to work elsewhere.

Cash balance plans also address potentially undesirable consequences of the traditional design. As companies downsize or sell businesses, it can be especially difficult for employees who are near that magic date when benefits under a traditional plan begin to accelerate substantially.

Under cash balance plans, employees have steadily increasing account balances and there is no need to work to a specific date before getting a significant benefit.

Employees who reach 100 percent eligibility for retirement benefits under a traditional plan often choose to leave. Cash balance plans, however, provide a significant benefit for each year of additional employment, encouraging companies to be able to retain successful workers.

Kodak developed its retirement plan to be cost neutral. That is, not significant costs or savings to the company. While overall cost reduction is a factor for some companies converting to cash balance plans, many channel savings from their pension plan to other areas of total compensation, such as a 401(k) match or stock options.

Instead of choice, most companies would grandfather employees close to retirement in the current plan and/or provide generous transition benefits for those who have significant service. These actions belie the notion that companies engage in conversions in cavalier manner, disregarding the interest of their long-service employees.

Because Kodak offered current employees a choice, extensive education and comparisons were necessary. Yet, even with all the disclosure we provided, we would not be able to meet the requirements of S. 659, the Pension Right-to-Know Act.

With the defined benefit system already in decline, we believe Congress should proceed very cautiously on disclosure and not add to the already substantial burdens of administering defined benefit plans.

However, S. 659 imposes new burdens, mandating detailed calculations for every employee, even those not facing a reduction, comparing benefits under the former and new plans at many different points in time. Meeting this mandate would require employers to gather and verify information on potentially tens of thousands of employees.

Given the extensive resources required to prepare these statements, we must assess the value of individualized disclosure. First, these individualized benefit projections can prove misleading, as modest changes in assumptions can dramatically affect the results.

Second, voluminous disclosure is not necessarily meaningful disclosure. The degree to which pension notices are read and used by workers are often related to their brevity and simplicity.

We are also concerned that S. 659's requirement for individualized projections applies to a very broad range of defined benefit plan changes. The burdens would be great in any of these cases, and the benefits can be limited. The bill's penalty of plan disqualification is also disproportionate and unduly severe.

We have discussed these various issues with Senator Moynihan's office and are pleased that his office has expressed sensitivity to these concerns and a willingness to continue discussions.

We at APPWP share the goal of seeing that workers are provided with useful information about how the retirement benefits are affected by a change to a cash balance plan. We are committed to working with the members of this committee to craft a practical solution that does not create an undue burden for our defined benefit system.

Let me close by expression APPWP's strong support for two bipartisan pension bills: your bill, Mr. Chairman, S. 646, and S. 741, sponsored by Senators Graham and Grassley. These bills will expand the employer-sponsored retirement system and offer new help to American families saving for retirement.

Mr. Chairman, Senator Moynihan, thank you for the opportunity to appear before you today. I would be glad to answer any questions.

[The prepared statement of Ms. Metras appears in the appendix.]

The CHAIRMAN. Thank you, Ms. Metras.

Now, Mr. Hill?

STATEMENT OF ROBERT HILL, ESQ., TRIAL ATTORNEY, DENVER, CO

Mr. HILL. Chairman Roth, Senator Moynihan, members of the committee, my name is Robert Edward Hill and I am from Denver, CO. It is good to be here.

Along with my co-counsel William Carr, we represent employees in two cases which do challenge certain aspects of the conversion to a cash balance plan. But I am here today to discuss the need that we have discovered for disclosure in the context when there are changes to the cash balance plans and to endorse the Pension Right-to-Know Act of 1999 as a very balanced and moderate response to these issues.

These are now academic issues, as I am sure you, more than anyone, know. These are bread and butter issues to millions and millions of American workers as they face increasing impacts from the changes to cash balance plans.

As part of our research of cash balance plans, my co-counsel reviewed transcripts and tape recordings of hours and hours of discussions regarding cash balance plans by the professionals who are drafting and implementing these plans for some of the Nation's largest employers.

To be candid, what we wanted to know was, what were they saying when they were talking to each other? What were they saying when they were not issuing press releases, when they were not making presentations here to Congressional committees, but what

were they saying when they were talking to each other about these cash balance plans?

With your permission, I will share some of that with you. In the first instance, there was one very constant theme. That was, the cash balance professionals uniformly agreed that it is difficult for employees to compare prior pension benefit formulas to the cash balance approach. This is a letter to one of the defendants actually in our company that says exactly that.

Senator MOYNIHAN. Could you read it, sir, so the audience will hear?

Mr. HILL. Certainly. "It is difficult for employees to compare prior pension benefit formulas to the cash balance approach."

If we go to the second chart, this is in a meeting of the Society of Actuaries in 1998, where there is a discussion indicating that "converting to a cash balance plan does have an advantage of, it masks a lot of the changes and allows you a lot more flexibility than you might otherwise see."

Senator CHAFEE. Who is you, the employer?

Mr. HILL. This is the employer adopting a cash balance plan. And this is the discussion, not with the employer, but a discussion among professionals who implement and draft these plans.

The CHAIRMAN. Were these employees, or who, that were making these statements?

Mr. HILL. These are the actuaries that are making presentations among other professionals, discussing cash balance plans.

The CHAIRMAN. So it was outside consultants.

Mr. HILL. Outside consultants, yes.

The CHAIRMAN. I see.

Mr. HILL. This is at a conference of Consulting Actuaries. This is back when cash balance plans were first beginning in 1986. Here again, you see, "The change can be used to mask a benefit cut-back." Use of this word "mask" is a word that I had not heard in this context until we did this research.

Senator MOYNIHAN. Actuaries are not supposed to mask. [Laughter.]

Mr. HILL. The theory is, actually, they are not supposed to mask. That is correct. That is one of the reasons we became concerned when we started reviewing these professional conferences.

Here you see at a conference of Consulting Actuaries in 1987, talking about transitions to install cash balance plans, "covering up cut-backs in future benefit accruals."

Here again more recently in 1996 at the Society of Actuaries, we see them talking, that you can do this transition. These plans help facilitate benefit changes, talking about if you want a reduction. You can do that without being too obvious about it.

This, with your permission, let me just play, because this is on a tape.

Voice. "But to answer your question from a different angle, I've been involved in cash balance plans five, 6 years down the road. And what I have found is that, while the employees understand it, it's not until they're actually ready to retire that they understand how little they're actually getting. [Laughter.]

Voice. You're right. But they're happy while they're employed."

Mr. HILL. That, to me, graphically demonstrates, both the comment and to some extent the laughter that occurred while the comment was being made, the need for more disclosure.

The current law is inadequate. The current law does not require disclosure of the kind that is meaningful to employees. What we have found in looking at this, when you hear a discussion, and this is last year, 1998, at the Enrolled Actuaries' meeting, talking about the current 204(h) notice. It says, "All it says, is describe the amendment. So you describe the amendment. No problem; they won't understand it."

We go on to the next reference here, October of 1998. "Since the notice requirement does not have to include the words that your rate of benefit accrual is being reduced, you just don't say those magic words and the employees go on."

The sad thing is, by the time the employees retire, it is too late for them to act on what they then know. By then, they do not have the option to switch employers, they do not have an option to increase their rate of savings, they do not have an option to do anything else to plan for the future. By then, those employees, and to some extent society, in general, and the government, are left holding the bag. It is for that reason that, after looking at this, we have concluded that additional disclosure is absolutely mandatory and necessary at this time.

Thank you very much. I would be pleased to answer any questions.

[The prepared statement of Mr. Hill appears in the appendix.]

The CHAIRMAN. If I could just ask one question of you, Mr. Hill.

Mr. HILL. Yes.

The CHAIRMAN. Are these actuaries people that are trying to push this kind of a program?

Mr. HILL. The answer is, I am sure some of them are. Some of them, no doubt, will receive fees if employers choose to adopt a cash balance plan and turn to them for professional assistance in making that conversion.

The CHAIRMAN. Well, I think we all agree that employees are entitled to meaningful information, no question about that.

Senator MOYNIHAN. I think that is why you introduced your bill, sir.

The CHAIRMAN. If I may ask a question of all the panelists. A major concern of many employees when their employer changes to a cash balance plan, is what happens to the benefit accrued prior to the conversion? When converting from a traditional pension plan to a cash balance plan, what are the requirements for establishing an opening cash balance?

What are the requirements for retirement benefits accrued under the old plan formula at the time of conversion? Why would an employer want to make an opening cash balance account equal to the present value of their benefit under the old pension formula? Mr. Purcell?

Mr. PURCELL. Employers have very wide discretion in setting the opening value of a cash balance account. Let us say, for example, that the present value of the benefit accrued under the traditional plan is $15,000, which means if you were to take a lump sum distribution, that is how much they would have to pay you.

The employer does not have to set the opening cash balance at that level. They could actually set it higher, if they wanted. Many employers set it at that level, but if they wished they could set it lower. For example, they could say, well, the opening cash balance account is going to be $10,000.

What happens to the $15,000 they had accrued? Well, if they leave the employer they are entitled to that higher amount. They can never lose what they have accrued under the old plan when they retire or when they leave the employer.

However, by setting the account balance at less than that amount, as long as the pay and interest credits added to that $10,000 opening balance are less than the $15,000 that they had accrued under the old plan, they are effectively not accruing any new benefits. That is the wear away period, or the benefit plateau.

That is legal under the Employment Retirement Income Security Act, because for that employee, while he is still with the employer, the effect is a suspension of benefit accruals. He still owns the $15,000, he is just not getting any more until his cash balance account catches up to that.

However, if he leaves, he is entitled to that higher amount, the $15,000. But this can lead to periods of several years where the employee is effectively no longer accruing new pension benefits.

The CHAIRMAN. Ms. Metras?

Ms. METRAS. Many companies will choose to do what Kodak did and make the opening account balance equal to the accrued benefit. This makes the transition smoother for employees. That's the answer to the third part of your question.

Following on what Mr. Purcell indicated, some reasons why employers might choose to do something different and have the opening balance be less than the accrued benefit is because they might be projecting what age a person would retire at in determining how much of that early retirement subsidy that they are going to put into the account balance.

Also, depending on what the interest rate environment is, that can have an effect. Let us take for an example somebody who converted to a cash balance plan and set an opening account balance early in 1999, where the 30-year Treasury bond rate was at an historic low.

If you create your opening account balance with that interest rate, your balance is going to be way up here. Whereas, if you created it with more of a long-term rate, that might be a better approximation of what this will be for a person's career.

But, as Mr. Purcell indicates, if somebody leaves before the cash balance catches up to the accrued benefit protection, the person is still entitled to what they had under the old plan. We can never take that away.

We should also keep in mind that most companies would either grandfather employees near retirement and/or provide transition benefits for their long-service employees to mitigate the effect of this conversion.

The CHAIRMAN. Mr. Hill?

Mr. HILL. I would like to pick up on what they have both said, because I think they have both made good points, particularly Mr. Purcell, in talking about the discretion of the employer, which is

vast, in this area. We have to be careful when we talk about that, because there are very responsible employers who do what we would all agree is probably the appropriate and right thing.

There are other employers who would take advantage of that opportunity and can do things that I would say are less than totally honorable. Those are the ones, obviously, that I am most concerned about, and would hope you would be concerned about.

The wear away issue that both just discussed, I think, is a perfectly good example of the advantages of having some type of disclosure like the kind that would be provided in this bill.

If you are an employee and you are impacted by a change and you do not understand that impact, you could be, and we have seen circumstances where people are working from age 55 to 65, essentially attaining no additional, or very slight additional, pension benefits for those additional 10 years.

If there is not appropriate disclosure, those people do not necessarily have the knowledge to make an informed decision about whether they should take a competing job offer where they will be earning pension benefits, and instead they are blithely going along having been given generalized information, believing themselves to be accruing benefits and, as was said on the tape recording, not realizing until they retire that they worked for the last 5, 7, 10 years for essentially no additional pension benefits. That is why some provision with regard to the type of disclosure that is contained in the act, it seems to me, is so important. It is to bring to the employees the impact on them individually of the very kind of changes that both Ms. Metras and Mr. Purcell were discussing.

Absent that, such as we have right now, I can tell you, the employees are not understanding that. They are in some sophisticated companies. They are very aware of it in a handful of sophisticated companies, but in many, many, many companies, the vast bulk of companies, they have not the faintest idea that these changes are having the impacts they are having. Not until it is too late.

The CHAIRMAN. Let me ask the panel this question. I certainly agree that the employee is entitled to adequate information in understandable form that enables him or her to make an intelligent decision. The question is, how do we implement that? Obviously, inadequate information is not fair to the employee or his family.

On the other hand, we do not want to do as we so often have done in the past in government, have so many heavy requirements that, number one, it is too complex for anybody to understand. I would like to get some idea of what you think is the basic information, and in what form that it would be most useful to employees. Mr. Purcell?

Mr. PURCELL. S. 659 has a number of requirements, including describing the present value of the accrued benefit under the old plan and the opening balance of the cash balance account. This is something that any employer would have to calculate for an employee who was departing, because they would have to compare these two values to see which one was greater and which one the employee was entitled to.

I really feel that, given my professional experience, I can really only comment on the technical aspects of these calculations. What I would say, is that the calculations themselves are not terribly dif-

ficult for anyone who has a PC and some software like Excel or any of the spread sheet programs. They can all handle these kinds of calculations.

The nice thing about computers is, if you can do it once you can do it 10,000 times. That is what computers are good for. But I cannot really comment on the difficulty imposed on an employer of gathering each particular element required for these pieces of disclosure. Some of them, as I said, are items that an employer would require in their day-to-day course of business.

Some of them are set forth specifically in the bill: use this particular interest rate published in the Federal Register, for instance. But not all employers keep records in the same way. For instance, for employers who have merged, there is the problem of gathering records from employees from different subsidiaries.

The short answer to your question, is I think that it is essential that an employee know the opening value of cash balance account compared to what they have accrued under the old plan.

The CHAIRMAN. Ms. Metras?

Ms. METRAS. Well, we believe that additional disclosure would be appropriate in changes like this where the structure of the plan is changing. We do want participants to have the information they need to plan for their retirement.

We have been very supportive of H.R. 1102, the Portman-Cardin bill, which requires a description, a very clear description, of what the change is. We think that, for many employees, that will be most helpful to them.

As Mr. Purcell indicated, companies calculate the opening account balance anyway, so that would be something that could be provided fairly easily as long as it was done after the fact.

The accrued benefit for some employees might be helpful so they know what they had earned under the plan, and then they can feel free to compare that to the opening balance. In some cases, hypothetical examples could be workable. We think that should be about the limit of what companies are required to do.

In individual situations, the employer-employee dynamics of a given company might encourage companies to do more than that, but that should be up to the company, given their own situation with their employees to go beyond what are the legal requirements.

The CHAIRMAN. Mr. Hill?

Mr. HILL. Well, I think striking the balance, in two ways, is important. One, striking a balance between too much and too little, which I think is important. You can bury people with 30 pages of meaningless information. I would suggest, that is not going to help people make their future decisions. That is why I think this bill has focused in on a few key elements that would permit people to make meaningful decisions.

The second balance, I think, is this balance of burden versus implementation. My experience in this area is that the balance has been struck properly in the act. As has been indicated by both of the previous witnesses, the initial account balance is being calculated individually already and it is being done on computers. They are not doing it by hand calculators, I can assure you. It can be repeated with relative ease for every employee in the company's employment.

The second, is that you have to protect the previous benefit, and that also has to be calculated. I mean, that is part of the conversion process. So that stuff is already done.

The running of a software program to plug in what the benefits are at 3 years, 5 years, and 10 years is a matter of poking a few additional buttons on the computer, and the spread sheet comes out. As it runs out, it has two extra lines, or three extra lines.

So I have not understood, and cannot understand, how a burdensomeness argument can be made on that, as a practical matter, in the context of these plan changes and what records we have seen every employer keeping.

The other issue is this question of a suggestion that somehow these projections are going to mislead people. It seems to me, that also would be a concern if there was a valid concern. Obviously, any assumptions that are run have some variability in them, and we all recognize that.

But every employer, I would suggest—and I am sure Kodak did it very carefully—ran exactly these same kinds of calculations and projections to determine what the cost to them was going to be of making the change. As was indicated, they wanted this case to be cash neutral in terms of the impact. They ran those projections and they made their decision based on those projections.

If employers make their decisions based on those projections, why should employees not be making them on exactly the same kind of basis?

Therefore, it seems to me, providing that information, letting employees know, and letting them then live their lives and make their decisions in a knowing fashion would be extremely attractive and of great benefit.

I have got to say, this is a problem for all of us. It is not just those of us who are living under these plans, if some of us are. But it is a problem for everybody because, as you know, the saving rate in this Nation is not something we are going to be bragging about. To the extent people can make intelligent decisions at 45, 50, and 55 about what they need and realistically assess what they need, we are all going to be much better off in the future.

Ms. METRAS. Mr. Chairman, may I comment on Mr. Hill's comment?

The CHAIRMAN. Sure.

Ms. METRAS. I would like to make three points. First of all, Mr. Hill indicated that Kodak had made some assumptions in determining the costing of the plan. What might not be obvious, if you have not lived through this, is when you do the costing you run these at lots and lots of assumptions. We did our base assumptions and then we varied each individual assumption, such as salary rate, increased terminations, increased hiring rates, decreased terminations, decreased hiring rates, discount rates. We put them all together. We spent months working on the costing of this program to make sure that it was going to work.

Now, how does that relate to what we give to employees? First of all, it is not just a matter of plugging in numbers, as both Mr. Purcell and Mr. Hill indicated. Yes, you are calculating the accrued benefit and you are calculating an opening account balance. But when you are doing projections, you are also saying, we have to

say, is what happened last year, is that representative for the future?

Let us say somebody was out for 6 months. Do you want to just project their future service at only six months a year? So anybody that was coming in and out and was not there the whole time, or came over from another company, they have to be looked at individually.

The misleading part, how that relates, is when Kodak did their projections and gave them to employees, the interest rates were very low. So what that does, is it makes the traditional plan look much better compared to a cash balance plan. But if we had just left it at those statements, we would have left our employees with the wrong impression.

The interest rates have increased substantially since that time, from close to 5 percent to now over 6 percent. What that does, as the interest rate goes up, the traditional plan goes down and the cash balance plan goes up.

So we held employee meetings, we have phone centers, we have software for the employees that they can change any and all of the assumptions, and we have encouraged our employees to change assumptions in order to get a picture of what this might look like under changing economic conditions.

The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. Mr. Chairman, speaking of getting information right, I thought I was going to a meeting of the Rules Committee. As time has passed, I find I am quite senior on that body, which only meets twice a year. I got there on time, but found the meeting had been canceled.

I think Mr. Chafee is next, if I could suggest.

The CHAIRMAN. Senator Chafee? We will also submit written questions and ask that they be answered promptly.

[The questions appear in the appendix.]

Senator CHAFEE. Well, Mr. Chairman, I find this a very complicated subject, I must say. I am reminded of a cousin of mine who was a history professor at Middlebury College and famous for being a very rapid speaker when he was giving his lectures. As a matter of fact, it was said if the poor student dropped a pencil, by the time he picked it up he had missed two centuries. [Laughter.]

So I, first, listened to Mr. Hill and Mr. Purcell put this off, it is just a computer, no problem, punch a few things and it is all set. Then I listened to Ms. Metras about the difficulties that they had to go through and it did sound difficult, all the items you have to look at.

Could you tick off some of those items you have to take into account as you tried to calculate this to send it out?

Ms. METRAS. Yes. If everybody just came to the company, stayed there, and did not leave, and worked full-time, this probably would not be very difficult at all. But we had a lot of people that transferred back and forth between subsidiaries, we have had people that transferred in from different acquisitions, we had people that we divested that came back.

Some came back before assets were transferred, some came back after assets were transferred, which means you treat them differently. We had people who came back from divestitures where

they had been given a bump-up in their frozen benefit because the benefit was not transferred over at that time.

We have people that joined the company during the year. We used 1998 data to do our projections. We had people that joined the company during the year. We had people that were on leave of absence, we had people that worked part-time that are career part-time employees. We had people that worked part-time for the first time in their life. We had people that switched from part-time to full-time. That is just in the qualified plan.

Then when you want to get into the $160,000 limit, and compensation that you cannot include, and things like that, people with foreign service, having lived through that, it is not something I would really want to do again real soon.

Senator CHAFEE. You mean, in the foreign service they would get extra monies for living abroad?

Ms. METRAS. We had some people that we have an umbrella plan that does not pay off from our qualified plan for people that maybe worked in England or France and then came to the United States. That all had to be taken into consideration. This took us a good 6 months of effort, of elapsed time, to get these statements where we think that they were right. Then you have to consider, how do you project the salaries, how do you project the service for those situations that I mentioned.

There is an awful lot of manual work that is involved. If you do not have people on your staff that know exactly what they are doing, it would make it much more difficult. We were very fortunate in that the vendor we had used had worked with us for a number of years on our retirement system and knew our retirement system in and out, and that made the process go much more smoothly for us.

Senator CHAFEE. I am very sympathetic to the view that you want to give the employee as much information as possible. As a matter of fact, I am a co-sponsor of Senator Moynihan's legislation. S. 659.

What do you say, Mr. Hill, to what Ms. Metras had to say?

Mr. HILL. Well, I would not quarrel for one moment.

Senator CHAFEE. I must say, she did raise a lot of things, Europe, the people abroad, and all of those problems.

Mr. HILL. I would not suggest for one moment to quarrel with her description of what her company went through to make the necessary calculations and determine what the cost to them would be, and what an appropriate plan, I will call it design, would be, in their view, for the employees.

One question, though, that that raises, it seems to me. That is what I will call the disproportionate access to knowledge that we are dealing with here. In a realistic sense, what chance does an employee have to do anything even remotely comparable to that in evaluating, what is the impact of this plan? You think you dropped the pencil and lost two centuries? I will give you some of these plans and I will give you their summary descriptions and I will give you every piece of information the employee had——

Senator MOYNIHAN. And give him two centuries and see if he can understand it. [Laughter.]

Mr. HILL. Exactly what I was going to say. I will give you two centuries, and I would like to come back and ask you whether you then understand it.

Senator CHAFEE. I want one commitment from you: that you promise not to give me that information. [Laughter.]

Mr. HILL. I promise not to give you that information. But the point of that is, with that information, unless you have access to the computer data base, unless you have access to the assumptions that are being used, unless you have access to the actuaries, you are not going to be able to figure that out.

So then the question is, what is an efficient way? I mean, we do not want to send off all tens of thousands of Kodak employees to replicate that process. What is a reasonable way to balance it, to provide those employees with the information they need to make their decisions?

Not to make the company's. They do not have to replicate all of that, but the basic information they need to know, if I stay 3 years, if I stay 5 years, if I stay 7 years, what is this going to do to me, where am I going to be, and what do I need to do to be where I want to be?

Because those are the decisions each of us should want that employee to be making; should I be saving more, should I be investing more, should I be moving to take another job because I am not going to be earning pension benefits here but I could earn pension benefits if I went someplace else?

As a good government, we want them to be making informed decisions. I would suggest, the employers should want them to make informed decisions. It is short-sighted not to. But some are short-sighted, and I am not accusing Kodak.

Senator CHAFEE. I would just say one thing. The classic problem we have here, Mr. Hill, obviously, and I think Senator Moynihan and Senator Roth mentioned it earlier, and that is, by levying too many requirements on the employer, the employer says, forget the whole thing; it is just not worth the headache, I do not want it. Therefore, we are going backwards instead of forwards in trying to obtain the information for the employee that we think is necessary.

Mr. HILL. That is why striking that balance we were talking about is so important, and I think your act does that. I think this act does that.

The CHAIRMAN. Senator Kerrey?

Senator CHAFEE. Thank you, Mr. Chairman.

Senator KERREY. Thank you, Mr. Chairman.

Let me say at the beginning, I hope this committee produces a piece of legislation sometime soon that will cut America's income taxes. I think, as a part of that, we ought to try to incorporate other things that will help Americans save money.

The CHAIRMAN. We will try to accommodate the distinguished Senator. [Laughter.]

Senator KERREY. We will be taking from the American taxpayers approximately $3 trillion more than we need to pay the bills over the next 10 years. It does seem to me that, if our accounts were at dead even, if we were in balance over the next 10 years and I were to come to this committee and say, I would propose that we increase taxes by $3 trillion so we could collect $3 trillion more

than we needed, that I would probably be the only one that would vote for it. So it does not seem to be unreasonable. I say that, because I hope that we can incorporate into that some pension reform.

Senators Graham and Grassley have a piece of legislation that I am a co-sponsor on that I think will help people get into pensions and make it more likely, especially in small businesses, that that happens.

I am a sponsor of Senator Moynihan's bill as well. I hear there are concerns about it, but it does seem to me that, if businesses are going to offer increasingly and use cash balance plans, that we have to answer the question, what kind of regulatory structure do we have for it?

That is what Kodak is saying, here are some regulatory concerns that we have with it. I do not hear you saying that we should not attempt to inform the employee so they can make an informed decision. It seems to me that we need to answer the question, how do we do it in a way that balances both concerns.

I have no questions, Mr. Chairman, of this panel. I just want to make the point that I hope this committee will take charge of the idea of cutting taxes. I hope, as a part of that, that we will also take charge of the idea that is very closely associated with that, is the need to help Americans plan for their retirement future by saving money, whether it is through IRAs or whether it is through pensions. I hope we package that part of what we are trying to do with this idea of the need to cut income taxes.

The CHAIRMAN. I would just comment to the distinguished Senator, he is playing my song. I have a lot of sympathy for what he said.

Senator KERREY. I have been around long enough to know that you should always play the song of the Chairman if you can. [Laughter.]

The CHAIRMAN. If I could, and then we will call on you, Senator Moynihan. One thing that concerns me, is that we are trying to expand pensions with small business. If there is any area where there is a lack of coverage, it is for those who work for, as I say, small business.

Do we need the same requirement? If we pile on more regulations, is that going to discourage small business, or can we treat them differently? Is there any grounds or sense to that? Mr. Hill?

Mr. HILL. Well, you can treat them differently, and this bill would treat them differently. It is limited to what I will call large employers. There are some of the same.

The CHAIRMAN. How are they defined, do you recall?

Mr. HILL. I think it is 1,000 employees and more, if I remember correctly.

Senator MOYNIHAN. That is correct.

Mr. HILL. I apologize if I am misspeaking, but that is the way I recall it.

Senator MOYNIHAN. You go it right.

Mr. HILL. As a practical matter, at least as we sit here today, the cash balance plans have been substantially focused on what I will call the large companies. Therefore, while this does not impact adversely or positively in any fashion the small employer, it does

deal with the problem as we know it today. Whether that would be the same testimony one would give 5 years and 10 years from now, I do not suppose we know the answer today.

But, as we sit here today, this does address the primary need for disclosure in the cash balance transition area, because that is where it is occurring. It does have the benefit of not imposing any additional burdens on small employers.

The CHAIRMAN. Senator Moynihan, I think, is next.

Senator MOYNIHAN. Just to make a very few remarks.

One of the themes that keeps coming up before this committee in recent testimony on a range of issues, international trade, for example, is the importance of transparency. Transparency is not regulation. Indeed, the most important forms of transparency are generally agreed accounting methods, which are extra-governmental altogether, but absolutely fundamental. I think of our bill, if I could say to my co-sponsor and Senator Kerrey—it is our bill, not my bill—this is asking for transparency. Mr. Hill, you agree on that?

Mr. HILL. Absolutely.

Senator MOYNIHAN. Mr. Purcell?

Mr. PURCELL. Yes, I would.

Senator MOYNIHAN. You agree. Then now here is a chance for Kodak. [Laughter.] Come on. Let us hear it for the Genessee Valley.

Ms. METRAS. I guess, Senator Moynihan, I am not sure what you mean by transparency. But I would like to say, we need to be very careful about placing additional requirements on an already strained defined benefit system.

As the Chairman had indicated, the cash balance plans are the only areas where the defined benefit system is growing. I think the committee is aware of the benefits of a defined benefit plan, such as PBGC insurance, employer bearing the risk, availability of annuities, that we need to be very careful that we do anything that is going to cause employers to say, I just do not want to stay here any more.

Senator MOYNIHAN. Well, I much agree. But would this measure before us have made it difficult for you in your recent reassessments?

Ms. METRAS. Well, I think Kodak went to the extreme in the amount of information and disclosure they provided employees. If we could not meet the requirements of the bill with all of the work that we did, I think that might indicate that there are some problems.

Senator MOYNIHAN. But the bill would not have impeded your process, would it? I think you told us that you found this, as such, would not inhibit what you have done.

Ms. METRAS. Because we had decided that we were moving in this direction. Now, if we had to put all of the additional requirements of the bill into our communications, the communications package would be a lot less attractive to employees and it would make the plan look a lot less attractive.

Senator MOYNIHAN. I think of Mr. Hill's point about a 30-page, small-print package. But I think we can work that out. We are not trying to regulate, we are just trying to pass out information and

make it available to people who need it in a situation where things are changing.

I would congratulate Mr. Hill on getting all of those tape recordings of all of those societies. I did not know there that many actuarial societies.

Mr. HILL. I do not think we did either when we started.

Senator MOYNIHAN. I do think, Mr. Chairman, that we have something good on board here. I would like to think that Senator Kerrey is right in saying, let us include it in the general package. We are just asking that people be given information, and let them make their own choices and not dictate them, or not even try to influence them.

Mr. Purcell?

Mr. PURCELL. If I might comment, briefly. I think that there are two aspects of the bill. One, says identify the starting point. Tell the person what they have accrued under the old plan and what they are starting out under in the cash balance plan.

As I think Ms. Metras accurately portrayed the concerns of many employers, at least from what I have been reading in the press, it is the projections that many of them are uncomfortable with. Having spent 5 years at the Congressional Budget Office trying to project Medicaid spending, I am extremely sympathetic to concerns about projections that do not come true. So I think that the real area of concern is the degree of specificity of what they are trying to project.

Senator MOYNIHAN. Well, let us work on that. But remember, the President's projections of the revenue surplus are absolutely fixed and given. Senator Kerrey means to make the most of them. [Laughter.] Thank you.

The CHAIRMAN. Could I suggest, Senator Moynihan, it might be helpful if each member of the panel would look at the proposed legislation and spell out where they see problems possibly arising.

Senator MOYNIHAN. Would they do that, Mr. Chairman? I am sure they would. Poor Mr. Purcell. You have to say yes.

Mr. PURCELL. Yes. Actually, I think I just identified it, which is the section of the bill that says, now project benefits 3, 5, 10 years into the future using these assumptions. A lot of employers, I think, are worried that employees are going to come in and say, look, last year you sent me this letter and said this was going to come true, and it did not. That is a concern.

Senator MOYNIHAN. Let us know what you think, and we will respond.

Senator CHAFEE. Can I ask one quick question?

The CHAIRMAN. Senator Graham.

Senator CHAFEE. I am sorry. Go ahead, Bob.

Senator GRAHAM. Mr. Chairman, I do not have a question for this panel. But I would like to make a statement which somewhat attempts to combine the subject of today's hearing with what Senator Kerrey said relative to his reluctant acceptance of the concept of income tax reduction.

First, the President, since the State of the Union address in January of 1998, has stated that his policy would be that, before any of the consolidated surplus were used for any other purpose, that, first, we had to assure the solvency of the Social Security system

for three generations. He has reiterated that that continues to be his policy.

In the State of the Union of 1999, he added also strengthening Medicare, although without the quantifiable precision that he gave to the Social Security statement. It seems to me that if those are the bridges that we have got to cross before we can consider the issue of tax policy beyond that, that this may offer us the opportunity to elevate the issue from one of Social Security reform to the broader issue of retirement security reform, which would include Social Security, but also the other major components of retirement security, which are savings, which the Chairman has been particularly a national leader on, and the issue of employer-based pension plans.

I would suggest that, maybe as we start to approach that first bridge that we have got to get over in order to get to the glory land of being able to consider other tax cuts, that we might want to broaden the issue beyond what the President had said so that we can deal with the interrelationships of all of these various plans.

I think one of the things that this panel has indicated is the degree to which all of the components of retirement security are at least first cousins, if not siblings, of each other in their policy implications.

The CHAIRMAN. I would say to the distinguished Senator from Florida that it seems to me a principal purpose and thrust of the tax legislation should be to address the problem of savings and retirement. I am shocked and deeply concerned about the lack of savings.

I think retirement depends upon three legs to the stool. One being, obviously, Social Security. It is probably the most important domestic program we have. Two, is the employer pensions. Third, savings. So, again, I would say to my distinguished friend that we are thinking much along the same lines on that issue.

Senator CHAFEE. May I ask a quick question, just very fast?

Ms. Metras, you ticked through the things that you reviewed with your employees' records to try to ascertain what the benefit would be, and so forth.

Are you saying that Senator Moynihan's legislation adds to those and increases the difficulty of your task? In other words, the list you just ticked off was pretty impressive. I am a co-sponsor of Senator Moynihan's legislation. But you are saying that adds additional challenges to you?

Ms. METRAS. Yes. Yes, it does, Senator. First of all, the bill applies to people that are not even involved right now in the change. For example, our Puerto Rican unit is not involved in this change. We would be required to send statements to those folks also. It requires that we would attach annuity tables, which we did not do because they were not really very helpful in this kind of change that we have.

It would require that you always convey present values, whereas our people who were not eligible for lump sums, or if you were not eligible for a lump sum for your entire benefit, we did not do present values. We did an approximation of how much money it would take to purchase the annuity that we are putting on your statement. Then there are some little things.

Senator CHAFEE. Well, no need to go into that. I think, Mr. Chairman, it would be worthwhile to stay in touch with Ms. Metras as we try and work our way through this.

Senator MOYNIHAN. Which we have done. I mean, I am sorry about Puerto Rico. [Laughter.]

Ms. METRAS. It is better than the fact they would have to send these statements to the retirees, too, under the wording in the bill.

The CHAIRMAN. Well, I want to thank all three members of the panel. I think their testimony has been very insightful and helpful. I do think it is important.

Mr. Hill, I understand you had something to add.

Mr. HILL. Mr. Chairman, could I just respond very briefly to that last discussion?

The CHAIRMAN. Sure. Please.

Mr. HILL. I did not get my point in on that.

Projections, as Senator Moynihan pointed out, are not perfect. We all know as we sit here, if you make economic projections, the only thing you know is they will not be absolutely right. But we make those all the time and we make all kinds of decisions based on that. All we are suggesting is that the employees should have a right to make their decisions the same way you do on this committee, the same way we do in business, and the same way they do.

The second, is the substitute suggestion here is to use exemplars. Exemplars have two dangers, one of which is, they are based upon the same type of projections. So they have the same inherent deficiencies, if you will.

But they have a second deficiency which we see time and time again, and that is, the exemplars are picked to present an appealing picture. No employer wants to essentially send an unappealing message to their employee, for quite understandable reasons.

So those exemplars are picked to show the attractive side, if you will, not the down side. We have seen that repeatedly used, where the exemplars are very carefully chosen by the actuaries. They are accurate in the sense that they are accurate projections, but they do not represent the true impact on the employees.

That is the advantage of having what I will call a standardized disclosure so that employees can compare apples and apples instead of apples, oranges, and grapefruit. Thank you.

The CHAIRMAN. Let me ask you this question, Mr. Hill. You are a lawyer. What is the potential liability of an employer if their projections are inaccurate, as they will be?

Mr. HILL. I think the key question is, are the projections upon which they are based disclosed? Again, it is the transparency issue. One of the provisions requires that certain of the assumptions be disclosed. So I think the question here is, the act requires them to be disclosed in terms of the projections and the key assumptions.

Now, if, in fact, those key assumptions were in some fashion falsified, I think there might be some exposure. But as long as the projections are based upon disclosed assumptions consistent with the act, my initial reaction would be, I do not see it. It may be bad news, it may be good news, but if it is honestly disclosed news, I do not think there is a cause of action.

The CHAIRMAN. Any comment?

[No response.]

The CHAIRMAN. Well, our time is running out. We will want to ask you for further information. Please feel free to add any data that you care to. I think your testimony has been very helpful. Thank you very much.

Ms. METRAS. I would like to just reaffirm, we would be willing to work with the committee, too, on any aspect of this.

Senator MOYNIHAN. And we thank Mr. Hill's associate.

Mr. HILL. Thank you very much. He did the hours and hours of work.

The CHAIRMAN. It is now my pleasure to call on the next panel. We have four panel members. Scott Macey, who is testifying on behalf of the ERISA Industry Committee. He is senior counsel with ASA, Inc., a former subsidiary of AT&T.

Next, we will have Richard Pearce, who is president of Alliance Benefit Group. It is particularly a pleasure to welcome a fellow Wilmingtonian.

Next, we have Ann Combs, vice president and chief pension counsel of the American Council of Life Insurance, who will discuss benefits under the current system.

Finally, we have Lou Valentino, of Watson Wyatt Worldwide, on behalf of the National Defined Contribution Council.

We will start with you, Mr. Macey, please.

STATEMENT OF SCOTT J. MACEY, ESQ., SENIOR COUNSEL, AT&T/ASA, INC., SOMERSET, NJ, ON BEHALF OF THE ERISA INDUSTRY COMMITTEE (ERIC)

Mr. MACEY. Thank you, Mr. Chairman.

I am here today on behalf of the ERISA Industry Committee, commonly known as ERIC, of which I am a board member and the former chairman. After hearing the first panel, particularly Mr. Hill, I am a lawyer by training and education and I always thought that 800,000 lawyers was too many, probably, in the country. But I am convinced, after hearing today's testimony, that perhaps 20,000 actuaries is equally too many.

In any case, more importantly, I am here today to urge that this committee enhance retirement security by improving the provisions in S. 646 and S. 741 that will strengthen employer-sponsored retirement plans, by permitting ESOP dividends to be retained in a plan without the loss of the dividend deduction for employers, and by resisting efforts to prevent or discourage employers from establishing cash balance plan and other new defined benefit plan designs.

In addition, ERIC endorses the recent action by this committee to extend the current authority of Section 420 of the code that permits the use of excess pension assets to pay for current retiree health liabilities.

The law did not always impose the current vast array of limits on the benefits that can be paid from, or the contributions that could be made to, tax-qualified plans. However, between 1982 and 1994, scores of laws were enacted that repeatedly lowered the ERISA limits on benefit funding.

S. 646 and S. 741 reverse this trend, but none too soon. The baby boom generation is rapidly nearing retirement. If we delay actions,

burdens on employers and employees will increase significantly and detrimentally in the future.

These bills provide a critical opportunity to rectify this dangerous situation. Consider the following: many of today's workers' savings and benefit opportunities are significantly restricted by current limits in the code. Moreover, these limits imposed on defined benefit plans imprudently delay the funding of such plans.

Pensions are not a benefit for the rich, and most plan participants are not highly compensated. Over half of the money paid out, in fact, in benefits today goes to retirees whose adjusted gross income is under $30,000.

S. 741 also promotes pension portability by eliminating a significant number of stumbling blocks created by current law. ERIC is especially appreciative that the bill repeals the same desk rule.

ERIC also supports the bill's provisions that facilitate plan-to-plan transfers, by providing that the receiving plan need not maintain all of the optional forms of benefits and the like of the sending plan, as well as the provisions that allow roll-overs of after-tax contributions.

With respect to ESOPs, we strongly support the proposed change to the ESOP dividend deduction provision found both in S. 41 and the independent bill, S. 1132, and believe it will enhance employee ownership and retirement security to better accomplish the original objectives of this provision.

Finally, we are very concerned with some of the information we have heard this morning in the first panel concerning the unbalanced, inaccurate, and sometimes inflammatory publicity surrounding cash balance and other hybrid defined benefit plans.

We reject out of hand the edited statements of a few consultants and actuaries referred to and quoted, and we actually heard recorded, by Mr. Hill, indicating that cash balance plans can, or should, be designed so that employees would not have information relevant to their benefits and to their retirement planning.

Indeed, a review of materials that are provided to employees by major employers indicates to the contrary. As detailed in my written statement, S. 659, introduced largely as a response to this publicity, would kill the formation of innovative, new pension plans and hasten the already steep decline in defined benefit plans.

Plan sponsors must continually respond to changing economic, market, organizational, and demographic conditions and circumstances. Employers need flexibility to respond to these changes.

Cash balance and similar plans have met employee demands by providing an understandable, portable, and secure benefit where the employer, not the employee, bears the investment risk and the participants' benefit is guaranteed by the PBGC.

The objectives of S. 659 of assuring full disclosure and meaningful information are commendable. However, we disagree with the means suggested for achieving those objectives.

If the committee believes it must act in this area, we urge that its solution adhere to the following key principles. First, the rules under consideration should only apply to significant plan changes, and only to those participants affected.

Second, projections should be based on hypothetical examples. Third, disclosures and communications need to differentiate be-

tween generic information which can be provided in advance and specific or individual information which can only be provided subsequently, much for the reasons mentioned by the witness, Ms. Metras. We offer some additional principles in our written statement.

If the committee wants to act in this area, ERIC is prepared to work diligently with the committee and its staff to craft a solution that ensures employees have the information they need to understand the changes, understand the impact of the changes on them, and plan for their retirement, while not imposing undue burdens on the retirement system or confusing employees.

That completes my statement. I appreciate the opportunity to testify here today. I thank the Chair and the committee, and will be happy to respond to questions.

[The prepared statement of Mr. Macey appears in the appendix.]

The CHAIRMAN. I would say to the panel, your full statements will be included as if read.

Now we will be pleased to hear from Mr. Pearce.

STATEMENT OF RICHARD D. PEARCE, PRESIDENT OF ALLIANCE BENEFIT GROUP OF DELAWARE, INC., WILMINGTON, DE, ON BEHALF OF THE AMERICAN SOCIETY OF PENSION ACTUARIES

Mr. PEARCE. Thank you, Mr. Chairman.

My name is Dick Pearce. I am president of the Alliance Benefit Group of Delaware. I am an enrolled actuary, certified pension consultant. Our firm provides administrative services to approximately 250 firms, with plans covering about 25,000 participants.

Our firm is also a member of the Alliance Benefit Group, which is a national consortium of 14 consulting firms like my own that have service plans that cover approximately 380,000 participants, and collectively own about $4.5 billion in pension assets.

I am also past president of the American Society of Pension Actuaries, on whose behalf I am testifying today. ASPA members provide administrative and consulting services to approximately one-third of all qualified retirement plans in the United States. Most of these, however, are in the small business arena.

The fact that this Nation is facing a looming retirement income crisis should come as no big surprise to anybody who has looked at the demographics. The number of Americans over age 65 is expected to double, from 34 million to 69 million by the year 2030.

Even if the Social Security system can withstand the severe economic strain that this rapid demographic shift is going to place on it, people should bear in mind that that system was never meant to be the sole source of retirement income for United States citizens. It is essential that we have a strong private pension system in order to assure the economic well-being of our senior citizens.

The Chairman cited some statistics earlier. I have some different statistics. I think it lies in how you define what a small employer is and what a large employer is. But over 70 percent of the workers at larger companies will have retirement coverage.

If you get to employers with less than 100 employees, it drops to about 38 percent. If you get below 20 employees in a company—many companies that I service are that size employer, less than

20—you have about a 13 percent chance of having any pension coverage. It is almost like hitting the lottery.

I would like to, first of all, thank the Chairman and the other committee members for introducing some legislation that will be helpful and would remove some of the obstacles to providing retirement benefits to small employers.

One of the problems that is addressed in the bill is the deductibility problem that is very dramatic in 401(k) plans. What happens in a 401(k) plan, that is a type of profit-sharing plan. There is a 15 percent of covered compensation deduction limit in that type of plan. However, the way the rules work, the participant's salary deferrals are part of that 15 percent limit.

I will give an example of a company that I provided services to for over 30 years in Wilmington, DE that is a construction management company named EDIS. It is now in its fourth generation. The chief operating officer of that company is a fellow named Andy DeSavatino. They have always used their retirement benefits to attract, retain, and reward good employees.

They have a money purchase pension plan that provides an average contribution for each employee of about 9 percent of pay. They also have a discretionary profit-sharing plan that they feed when the times are good. But, being in the construction industry, it is cyclical and they cannot feed it every year.

In an effort to correct this, Andy DeSavatino decided a few years ago to put in a 401(k) plan to allow employees to do something for their own even when the company could not do it. The employees enthusiastically embraced the plan. In fact, the average deferral rate for that plan in 1998 was over 7 percent of pay. It generated a 3 percent employer match.

They had a good year in 1998. Andy wanted to feed the profit-sharing plan. But when we looked at it, we found that the 15 percent of pay contribution, we had used up about 11 percent of it with the salary deferrals and matching contribution. That left only a little less than 4 percent of pay that could go into the plan.

When we looked at how that would have to be distributed, we found that those who had most enthusiastically embraced the 401(k) plan were being precluded from getting additional contributions due to the 25 percent of compensation limit.

So that is a strange message to send to employees; we want you to be responsible and save for your own retirement, but if you do so we are going to penalize you in the form of reduced employer contributions on your behalf.

Both the Pension Coverage and Portability Act and the Retirement Savings Opportunity Act would exclude participant salary deferrals from corporate deduction limits, and I strongly encourage you to include that in the final legislation that goes through.

Another provision in the bills which will be very helpful is a safe harbor defined benefit plan. Start-up companies typically do not have the sources to provide retirement plans until the founders reach their mid- to late-40's. This late start makes a defined benefit plan a more logical choice. However, the complexity of the rule and the expense of maintaining such a plan is beyond the means of most small employers.

The Secure Assets For Employees plan, SAFE plan, as it is known, would provide a secure, fully portable, very straightforward, and administratively affordable defined benefit alternative and is a good companion to the simple plan that was enacted a few years.

Finally, I would be remiss if I did not touch upon the top-heavy rules, which are the number-one reason why small employers do not adopt the plans. Any family member is counted as a key employee in determining whether or not a plan is top heavy, no matter how little compensation they make or how trivial the role in the company is. Family members do not leave. They tend to inflate the percentage held for key employees.

The way the minimum contribution rules work, top-heavy 401(k) plans are twice as expensive for small employers as they are for large employers. What small business wants is not an extra break. We just want an even break, not an extra burden.

Thank you. I will be happy to answer any questions you might have.

[The prepared statement of Mr. Pearce appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Pearce.

Now, Ms. Combs.

STATEMENT OF ANN COMBS, ESQ., VICE PRESIDENT AND CHIEF PENSION COUNSEL, AMERICAN COUNCIL OF LIFE INSURANCE (ACLI), WASHINGTON, DC

Ms. COMBS. Thank you. I am Ann Combs, vice president and chief counsel, Retirement Security and Pension Issues, for the American Council of Life Insurance, and I am not an actuary. [Laughter.]

Mr. Chairman, you and the members of this committee are to be commended for this timely hearing on an issue of extreme importance to the Nation. The Retirement Savings Opportunity Act, which you introduced with Senator Baucus, will help Americans save more for retirement in both private savings plans and employer-sponsored retirement plans.

In addition, we would like to commend Senators Grassley and Graham for S. 741, the Pension Coverage and Portability Act. These proposals will increase pension coverage and greatly expand existing retirement savings.

These bills are being considered at a critical time. The aging of the baby boom generation, coupled with the uncertain future of government entitlement programs, make it critical that voluntary employer-sponsored plans and individual savings be strengthened to meet the retirement security challenges of the 21st century.

The employer-sponsored system has been a tremendous success in ensuring current and future retirees retirement security. The fact is, the majority of current pension plan participants and pension recipients are not wealthy, but rather middle income Americans.

Seventy-seven percent of pension plan participants have earnings below $50,000, and over 50 percent of pension benefit dollars go to elderly with adjusted gross incomes below $30,000. These are middle class programs.

With additional incentives, simplification, and expansion, this system will increase retirement security both in terms of the number of individuals covered and the amount of retirement income received. We believe the legislation we are discussing today, if enacted, will take significant steps toward achieving these goals.

The council supports both of these bills in their entirety, but I would like to single out a few provisions today that we think would be particularly helpful.

First, we enthusiastically support provisions in the legislation that would increase the limits on contributions to 401(k), 403(b), 457, simple plans, and well as IRAs. We also support the restoration of the defined benefit plan limits to their former levels, and an increase in the amount of compensation that can be taken into account in determining benefits.

Second, repealing the 25 percent of compensation cap for defined contribution plans, 403(b)s, and 457s will allow individuals to increase their retirement savings. This is particularly meaningful to middle income individuals who are most likely to be subject to the cap and to small businesses where pension coverage is the weakest.

Third, the current liability full funding limit enacted in 1986 has hampered employers' ability to steadily fund their plans over time. The repeal of this limit will ensure adequate funding over the life of a plan and will remove an impediment to the formation of defined benefit plans in the small employer market.

Fourth, catch-up contributions for older workers will greatly enhance savings opportunities for women who have been in and out of the work force, and for all of those who have been unable to save adequately for their retirement during their working years.

Fifth, Roth 401(k) and Roth 403(b) plans will give individuals greater flexibility in retirement planning by allowing them to determine when they want to pay taxes on their retirement savings.

Sixth, we strongly support provisions that are designed to encourage small employers to adopt pension plans, including revision of the top-heavy rules, reduced PBGC premiums, the phase-in of variable rate premiums, tax credits for pension plan start-up costs, and the SAFE defined benefit plan proposal.

ACLI is committed to expanding pension coverage among small businesses. We are exploring ways to even further streamline administrative burdens, and are discussing with member companies possible new plan designs that could be made available in addition to SAFE.

Finally, more Americans need to understand the importance, not just of accumulating savings, but of protecting those savings. As leading providers of both accumulation and protection products, life insurers are uniquely qualified to assist in developing strategies that will help Americans enjoy a secure retirement.

We need to adopt tax policies that reward responsibility and provide more flexibility so that individuals can protect themselves from loss of income should a family provider die early, from outliving their retirement savings through annuities which guarantee a lifetime of income, and from financial hardship that may arise due to disability or long-term care needs.

Again, we want to commend you, Chairman Roth and all of the members of this committee, for your recognition of the vital role

that employer-sponsored plans play in the retirement security of this Nation.

We encourage all of you to work hard for the passage of your bills, and I am sure you will. Rest assured, your efforts will ensure the future retirement security of millions of Americans.

The council looks forward to working with you as you move forward in your efforts to enact this vitally important pension reform legislation. Thank you for inviting us to share our thoughts with you today. I would be happy to take any questions.

[The prepared statement of Ms. Combs appears in the appendix.]

The CHAIRMAN. Well, thank you, Ms. Combs.

Now it is a pleasure to call on Mr. Valentino. I believe Mr. Lin is your associate.

Mr. VALENTINO. That is correct.

The CHAIRMAN. We are happy to welcome him.

Mr. LIN. Thank you.

STATEMENT OF LOU VALENTINO, WATSON WYATT WORLDWIDE, NEW YORK, NY, ON BEHALF OF THE NATIONAL DEFINED CONTRIBUTION COUNCIL; ACCOMPANIED BY PHIL LIN, VICE PRESIDENT AND ASSOCIATE GENERAL COUNSEL, DELAWARE MANAGEMENT COMPANY

Mr. VALENTINO. Thank you, Mr. Chairman and members of the committee. My name is Lou Valentino. I am the head of the National Defined Contribution and Administrative Practice of Watson Wyatt Worldwide.

I am here today as vice president of the National Defined Contribution Council, the NDCC, and chairman of the Government Relations Committee. With me today is Phil Lin, vice president and associate general counsel of Delaware Management Company.

Let me start by commending you and your colleagues for your leadership on this vitally important topic, and for holding this hearing.

It is no coincidence that Webster's College Dictionary now includes the definition of the Roth IRA, which is fast becoming synonymous with the phrase "tax-free retirement savings." The diligence of you and your colleagues in pursuing tax incentives for retirement savings is truly historic, and must continue.

The National Defined Contribution Council is a broad-based organization which promotes pension savings, primarily through employee-directed investment programs. Together, NDCC members manage and administer over 75 percent of all defined contribution retirement plans in the United States.

In Washington, DC, our Government Relations Committee has provided technical support and practical insight to legislators and regulators in our areas of expertise. While promoting savings for all Americans, our main purpose in evaluating legislation is to make sure pension legislation is simple and administrable so that it works as intended in the real world.

Our main comments today are to encourage you to make pension reform the centerpiece of the tax bill this committee is expected to mark-up in mid-July. As part of the pension reform effort, there are three points that I would like to make at the outset.

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First, complexity in employer-based pension systems deters American workers from reaching their retirement goals. It needs to be a major consideration for any legislative proposal.

For example, subjecting proposals allowing catch-up contributions to complex non-discrimination testing rules will only undermine the desired intent of the proposals and prevent Americans from saving more for retirement.

Second, existing limits, surprisingly, prevent even middle class Americans from saving adequately for retirement and need to be increased.

In addition, pockets of American workers need targeted additional catch-up relief from existing limits. They include women who have been out of the work force and baby boomers nearing retirement who have not had the opportunity to save sufficiently for retirement.

Third, unnecessary regulatory barriers and administrative costs and burdens are impediments to employers in establishing and promoting private pension plans, particularly small employers.

Our written statement provides additional discussion of these points. What I would like to do now is focus on the issue of complexity, both in general and on a couple of points in particular regarding catch-up contributions and portability.

Let me start out with a straightforward axiom. If taxpayers cannot understand our laws, regulations, and administrative rules, or if compliance with those requirements is prohibitively expensive, they will do one of three things: they will either engage in shortcuts, not fully comply, or not take advantage of the laws that are in place which are intended to benefit them.

While the American public is becoming increasingly more aware of the vital nature of retirement savings, complexity and the law still acts as a deterrent to savings.

If there is any complexity, uncertainty, or any uneasiness in the way the laws work, taxpayers may simply not participate, as evidenced by the low participation rates that we see today. This goes also for employers not willing to establish or fully promote plans as well, particularly for small employers.

I would like, now, to touch upon complexity as it relates to the catch-up provisions. One of the most beneficial new legislative proposals being considered by Congress is the Retirement Savings proposal included in Chairman Roth and Senator Baucus' bill that allows participants who have reached the age of 50 to catch up for lost time and contribute additional amounts to their retirement plans.

Other types of catch-up proposals have been introduced on a bipartisan basis in both the House and Senate. Some of these would require the catch-up to be subject to complex non-discrimination testing.

The NDCC wholeheartedly endorses the catch-up concept which benefits baby boomers who are now approaching retirement age and have not had the opportunity to save adequately for retirement, and who are not prevented from saving more because of existing limits.

Typically, these individuals had other financial goals earlier in life, such as paying for school tuition, reducing home loans, or tak-

ing time off to raise their children. As they approach retirement age, they are more focused on reaching their retirement goals, but are prevented from doing so because of existing limits in the pension laws.

A recent industry study survey done by one of our members shows that over 37 percent of individuals who are prevented from saving more because of existing limits are over age 50.

This percentage applies equally to both lower-paid employees whose contributions are restricted by Section 450 limits, as well as others whose contributions are restricted by 402(g) limits, or other existing non-discrimination tests.

The objective of legislative proposal is to let these individuals catch up for lost time and allow them to put more away for retirement. The catch-up proposals would aid these employees in reaching their retirement goals, but only if the proposals are not subject to the current complex non-discrimination rules.

The original intent of the catch-up proposal would therefore be frustrated, where one hand giveth and the other taketh way.

Ease of complexity and portability. For us, this is a no-brainer. Perhaps the best example of legislative proposals addressing complexity are the proposals dealing with portability. That is, the ability to take your pension assets with you as you change jobs. Unfortunately, it is very problematic and very difficult, and Americans do not need, nor deserve, this level of complexity.

The portability proposals introduced by Senators Graham, Grassley, and others are extremely important because they address the problem of complexity by allowing individuals to take their retirement money with them as they change jobs. Moreover, they do so by making life simple and eliminate a lot of the complexity.

Let me just conclude, if I may. The NDCC supports these and all the other proposals of the Chairman and Senator Baucus, including the Roth 401(k), the Pension Coverage and Portability Act of S. 741 introduced by Senators Graham and Grassley, and co-sponsored by many other members of this committee.

Rather than picking and choosing from the items included in these bills, the NDCC supports passage of a well-reasoned package which contains these legislative proposals. If revenue is unavailable to pass all proposals immediately, we would recommend generous phase-in rules for the most costly proposals.

Again, thank you for the opportunity to testify today.

[The prepared statement of Mr. Valentino appears in the appendix.]

The CHAIRMAN. Well, thank you, Mr. Valentino. Both Senator Graham and myself are glad you found that final page. [Laughter.]

All of you have talked about increasing the current limits and how important that is. However, some would say that this would only mean increases for upper income people. Ms. Combs, you partly addressed that in your opening statement, but I would appreciate any comments. How do you answer that charge?

Mr. Macey?

Mr. MACEY. I would think that it could sweep in for some high-compensated people. But we have a problem in this country, that we do not have enough retirement savings for the rank and file.

The current limits limit rank and file employees, in addition to higher-compensated employees.

The number of higher-compensated employees that it limits is relatively small compared to the number of rank and file employees. It also limits the funding because the funding limits, built on defined benefit plans, are based upon the current compensation rather than projected future compensation.

Many people who are in their 20's and 30's today, at relatively small compensation and certainly lower than the limits in the code that divide between highly compensated and non-highly compensated individuals are affected by those limits.

In addition, the limits under 402(g) that limit the amount that can be put in, pre-tax, into a 401(k) plan discourage people who, at their later years when perhaps they have paid for a child's education and the home mortgage, but only earn $40,000, $50,000 or $60,000, they cannot put in what they would like to bolster their retirement security.

The 25 percent limitation on contributions also did not affect the high-paid people at all. As a matter of fact, it affects only low- and medium-paid people who would like to put more money into 401(k) plans.

The 401(a)17 limit of $160,000, which has been lowered and lowered a number of times and which would be close to twice that, if the original ERISA provision was in effect, will impact, and impacts today, people who are projecting forward to a much greater benefit and much higher salaries in the future. And the funding of that benefit under a defined benefit plan needs to be based on that higher salary, but it cannot be because of the limits under the code.

So, for the various limits, yes, it could assist a few higher-paid people, but I think it will benefit, to a great number, the rank and file and middle class and middle income people.

From a policy perspective, we really do not want to divorce the interests of the policy makers and higher paid people and people who run companies from bolstering and having a strong interest in the health and vitality and growth of both defined benefit and defined contribution plans.

We do that by imposing artificially too low of limits on that, where they look to non-qualified plans for most of their benefits rather than the qualified plans. In the non-qualified plans, other than the excess plans which can be applicable and applied to all employees, the other non-qualified plans, because of the limitations they have to apply to a select group of highly-compensated management employees, cannot apply to the rank and file. So they are truly losing benefits, and there is no way for the companies to make up for that loss.

The CHAIRMAN. Mr. Pearce?

Mr. PEARCE. Yes. The example that I cited earlier about a firm that actually did away with its profit-sharing plan as a result of not being able to allocate a reasonable, uniform rate of compensation to everybody, the people that were affected by that were those who were affected by the 25 percent of pay limit who had put 10 percent of their savings into the 401(k) plan. Many of those people were making $30,000 a year or less. They certainly would not be categorized in anybody's definition as highly compensated.

I also echo the sentiments expressed earlier, that the restrictions this places on defined benefit plans for the adequate funding of them, you could take somebody who is 25 or 30 years old who is currently making $40,000 a year and do a 4 percent salary projection on him, and you might well find yourself above the $160,000 threshold. We are not really allowed to fund toward that at all. So, it artificially reduces the amount that you can prepay now.

At the end of the day, the employer is going to pay the cost under a defined benefit plan and the only offset he is going to get to that cost are the investment earnings on the contributions that he puts in.

To the extent that the funding rules back-load contributions, you are making the cost of providing those benefits higher because there are less investment earnings to apply as an offset against those costs.

So I strongly feel that the way the laws have been written in the past, particularly the OBRA 1987 full funding limitations, they have the effect of back-loading contributions by employers and thereby increasing the ultimate cost of the plan to the company, thereby encouraging the employers to abandon their defined benefit plans. That is why we have these issues cash balance plans today.

The CHAIRMAN. Thank you.

Ms. Combs?

Ms. COMBS. I am not sure there is a lot left to say. I agree with everything that has been said before. To reiterate what Scott Macey mentioned about aligning the interests of management with the rank and file workers, I think that is very important.

We should not kid ourselves; raising some of these limits will benefit higher-paid individuals. But more and more managers and middle management people are starting to get the bulk of their retirement income through non-qualified plans, and they have less of a stake in the qualified plan that the rank and file rely on. I think that is a mistake. We need to have management involved in those plans and committed to those plans.

I would also just maybe point out, historically, a lot of these limits and restrictions were enacted in an era of severe budget deficits, somewhat reluctantly, in an effort to raise revenue. We have a wonderful opportunity right now to reverse that course.

I do not think anyone thought at the time these limits were put in place they were good retirement policy. I think people thought that they were reasonable, given the environment in which we operated. But I think we can reverse course now, and we have a real opportunity, and we should do so.

The CHAIRMAN. Mr. Valentino?

Mr. VALENTINO. It is difficult to add on to what we have heard from the rest of the panel. I think we would actually concur with all of the opinions that we have heard to this point, particularly with regard when we are trying to get Americans to save. We do believe, as we stated, that these limits are really prohibiting the lower compensated individuals from saving, particularly with 25 percent of pay limit.

Phil, would you add to that?

Mr. LIN. Sure. Mr. Chairman, if I may add, the fact is that, as Ms. Combs pointed out earlier in her testimony, over 70 percent of

the participants in our defined contribution plans nationwide make less than $30,000.

The CHAIRMAN. What is the percentage again?

Mr. LIN. Over 70 percent.

Ms. COMBS. It was 77 percent that are less than $50,000.

Mr. LIN. Seventy-seven percent. Right. And with these employees making less than a certain amount of money, and with the current contribution limits in place, especially 25 percent, it is the lower of the $30,000, or 25 percent of your compensation under Section 415. A lot of those participants are even actually prevented from making the full contributions under the Section 402(g) limit, which is $10,000.

So it is not true to assume that the expansion of contribution limits only benefits highly compensated employees. Actually, they greatly benefit lower paid employees.

The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. Mr. Chairman, there is a line of G.K. Chesterton in which he says, "The question is very much too wide, and much too deep, and much too hollow, and learned men on either side make arguments I cannot follow." [Laughter.] But I am sure you are all right; Ms. Combs, as well.

I have one question which I would just ask if you have any thoughts on. The savings rate is a mystery. Every time we try to encourage it, the opposite seems to happen, or nothing seems to happen. It declines. It is now negativo for the first time since 1934. Yet, I wonder if we are not seeing in some respects, as against 1934, the enormous capital gains which so many people are experiencing through the stock market, in their pension holdings or their personal holdings, and in the housing markets, I think. I do not know much about housing markets.

These capital gains are not recorded in the savings rate, but would they have some effect on behavior such as if you saw your Federal employees' contributions go doubling every three or 4 years, and you looked at all that and said, well, I do not need to save. I have got this money that has been created, and I can spend all I earn, while at the same time accumulating monies for the future.

Anybody want to comment on that?

Mr. VALENTINO. I would like to comment on that. We are looking at the national savings rate being so low. But one thing I would suggest is that, within the private pension system, I think the rate of contributions has actually been increasing. The level of participation has been increasing for those individuals that are participating.

Senator MOYNIHAN. That is a form of saving.

Mr. VALENTINO. That is a form of saving in terms of the number of people saving and the amount that they are saving in 401(k) plans and defined contribution plans. It has actually been increasing over the past years.

So, within the private system, we are encouraging savings, be it from the plan sponsor or the financial institutions that are offering those products, and it is working.

What we need to do, is to broaden that base of individuals that are participating in the private retirement system to take advan-

tage of this. That is the comment that I would like to share with this committee.

Senator MOYNIHAN. Thank you.

Mr. MACEY. Presumably, accumulation and growth in assets that people have, embedded assets in their homes or their stock and whether it is in a qualified plan or not, drives some consumption-type behavior, I would assume. However, public policy and governmental policy in most sectors, not just in the private plan sectors, actually discourages savings.

I know today's hearing is not for the purposes of determining whether or not we should be taxing savings and what people put into CDs, bonds, and how they should be taxed and so forth. But today's purpose is focusing on qualified plans. Presumably, we should do everything that we can, within reason, at reasonable cost.

Based upon the budget numbers I saw coming from the Joint Tax Committee on the House side on Portman-Cardin, it seems to be reasonable costs, given the current situation, on raising these various limits so they more realistically reflect what people should be saving and the ability to save that people have, especially as they age through the work force.

We heard on the first panel today some concerns from committee members about older workers. Quite frankly, I think that the limits, the various plan limitations, have the most adverse impact on the older workers.

Senator MOYNIHAN. Thank you.

Ms. COMBS. I think another component of this effort to expand retirement savings is education. All of the groups, the council as well as the other groups represented here today, are involved in various campaigns to educate workers about the need to save for their retirement.

I think that is leading to some of the increase in participation among folks who have pension plans available to them in savings plans. So I think we all need to continue those efforts, and to expand coverage and make these opportunities available to more workers so they can take advantage of it.

Mr. LIN. Also, the fact that our current savings rate is low, I think, supports the argument that we should reduce the complexity with respect to pension law regulations.

Actually, pension law complexity has been cited as one of the major reasons for a lot of small employers not to offer any retirement plans at all, because they are scared and they have to spend a lot of money hiring lawyers, counselors, consultants, in order to keep the plan in compliance and they would rather not be bothered with that.

So I think the effort that is being made by Chairman Roth and Senators Graham and Grassley in their bills to try to simplify the plan regulations will further encourage a lot of small employers to offer retirement plans and, therefore, encourage the American people's retirement savings.

Senator MOYNIHAN. I might thank you all.

Mr. Pearce? You are from Delaware and do not have to comply with the rules that others do. [Laughter.]

Mr. PEARCE. I am not sure what is included in the savings allocations that indicate there is a negative savings rate, whether or not that includes 401(k) deferrals or not. But, again, we cited some statistics earlier that are pretty shocking for smaller companies where there are 20 or fewer employees. There is 87 percent noncoverage of any type of retirement savings.

That we should make an extra burden for those smaller employers to put in a 401(k) plan and require an actual doubling of the cost of providing the plan, makes absolutely zero sense to me. That is where we need to help the most. That is where the hemorrhaging is going on.

Why we put this extra burden on them makes very little or no sense. There is a fix in the Pension Coverage and Portability Act, I believe, that would cure some of those ills, and I strongly encourage you to take that suggestion very seriously.

Senator MOYNIHAN. Thank you. Thank you, Mr. Pearce. Thank you all.

The CHAIRMAN. Senator Graham?

Senator GRAHAM. Thank you, Mr. Chairman.

Senator Grassley regrets that he could not be here at this hearing today. He is the chair of the Aging Committee, which is holding a hearing concurrent with this. So I will try to ask questions that both of us would have asked within my five-minute time limit.

There is a frequently cited standard that Americans should attempt to prepare for retirement in a way that they could have approximately 75 percent of their last earnings as a stream of income during their retirement years.

Do you agree that that is a generally appropriate standard, and do you have any idea of how many Americans who are currently preparing for their retirement are doing so in a manner that will allow them to reach that standard?

Mr. MACEY. I do not have an answer to the second one, as far as how many Americans are working towards that standard. Whether 75 percent is the correct number, Senator, or some other number. It might, in some cases, be 60 percent, could be 80 percent, and in other cases it might depend on the compensation level and what your standard of living is. It is also very individualized.

But it is not unusual for companies when they are developing retirement programs to look at various sources, including the 401(k) and similar defined contribution plans, a defined benefit, if they have that, Social Security, and individual savings. There are really four different sources. Say, what should a person have, on average, at most compensation levels as they transition into retirement, and 60, 70, or 80 percent is a frequently cited number.

Clearly, whether Americans are doing so or not greatly depends on the private retirement system, on defined benefit and defined contribution plans, in addition to Social Security.

In the context of this hearing and with the provisions in your bill, I think it would encourage both employers and employees to try to meet those goals. Both the provisions of your bill and the provisions of Senator Roth's bill, both on IRAs and some provisions in there which cover qualified plans, we commend a great deal.

If I could take a minute to supplement my earlier statement. The issues that I discussed with respect to your bill, Senator Moy-

nihan,. S. 659, I think we, as an organization, and our members, agree with the objectives of your bill. Employees should have good disclosures, meaningful information about their benefit plans, the changes and the impact to those plans on them, and helpful information so that they can plan for retirement.

I have outlined a number of specific problems that we have with the means that your bill proposes to achieve those objectives.

Senator MOYNIHAN. So you will let us have them.

Mr. MACEY. I would love to.

Senator MOYNIHAN. I appreciate that.

Mr. MACEY. I apologize if I am taking this time unfairly, or anything.

Senator GRAHAM. I am certain that Senator Moynihan would agree this be charged against his future questions. [Laughter.] It would seem to me to be a very worthwhile contribution if some group—and it sounds as if you represent the kind groups that might be good candidates for this—could begin doing periodic assessments, through appropriate statistical selection of companies that would collectively represent the mixture of American employers and their employees, as to, what are Americans doing to get ready for their retirement?

If, for instance, we had such a study and it indicated that only 25 percent of American workers were on a track that would put them at a level of 75 percent of earnings, I think it would send alarm bells that would galvanize us to the urgency of doing some of the things that we are talking about.

Mr. PEARCE. There was a study that was conducted by the Employees Benefit Research Institute that indicates that one-third of the American work force has not even begun to save for retirement, and that 75 percent of Americans do not believe they have enough retirement savings.

Americans with low-to-moderate incomes are likely to be the hardest hit, since they are the most likely to have no savings. If we have a negative savings rate and we have a struggling Social Security system that is never going to get you to 70 percent of your final pay, you have got to have a very healthy private pension system.

So it seems to me, the more we can do to encourage plan sponsors to provide retirement benefits for their employees, the better off this Nation is going to be and the closer we will come to hitting those goals.

Senator GRAHAM. Well, let me make this deal with you. If one of your organizations would undertake to do that sort of annual assessment of, where are Americans in terms of preparing for retirement, I will reserve one of the rooms at the Capitol for an annual report card on American retirement in which you can release your study. Is that a good deal?

Mr. VALENTINO. It is an excellent deal. In fact, I think some of our member organizations actually have done those studies. I will make sure that this committee gets copies of that study.

I believe, to the best of my recollection, the last time I read through it, it was only 30 percent of Americans that may be saving adequately for retirement.

Senator GRAHAM. Only 30 percent. I would say, if that number had some credible documentation, it would be a very powerful statistic to drive the kind of reforms that you have all so eloquently endorsed.

Mr. LIN. Also, I just want to add that, based on the data that we have from our company which serves a lot of defined contribution plans, over 60 percent of the participants who are over 50 years old are not saving enough for the 75 percent. That is why I think that we need that catch-up provision very badly, especially the catch-up provisions that are not subject to a non-discrimination requirement.

By the way, I think 75 percent is an appropriate assessment, especially if you do not play golf. But if you play golf, I think you will need more than 80 percent of your income. [Laughter.]

Senator GRAHAM. We want to set it at a high enough percentage that people can do what all right-thinking Americans want to do, which is to retire to Florida. [Laughter.]

Mr. LIN. Where you have a lot of golf courses, right?

Senator GRAHAM. We have a few.

Mr. Chairman, I would like to ask a few more questions, but I will save those, if you are going to have a second round.

The CHAIRMAN. No. I think we will have written questions submitted. Do you want a little more time?

Senator GRAHAM. Could I just ask two questions? One, is there anything that you would suggest that private groups, associations that represent the interests of older Americans, or the Federal Government could do to better educate the 30-, 40-, 50-year-old Americans as to what they should be doing to get ready for retirement, with a particular focus on the financial aspects, but also including things like what they should do for their physical health, what they should do to prepare to use all the discretionary time that they are going to have, and the other aspects that go into a joyful retirement.

Mr. LIN. One of the things that I would propose is that, under the current ERISA regulations, it has very rigid regulation on what you can tell the participants with respect to their investment under their retirement plans. It subjects those people who are providing this kind of advice to fiduciary obligations.

So I think what we can do, is to ease the regulations in that area to provide more latitude to the financial world so that the investment professionals will feel more at ease to provide this kind of advice.

Otherwise, they will tend to shy away from these kinds of services because they are afraid that they might step into the fiduciary status, and therefore be subject to very rigid fiduciary obligations and possible liabilities.

Senator GRAHAM. Could I ask one final question? There are a number of proposals, including the President's proposal which is called the USA accounts, Congressmen Archer and Shaw have another proposal, all of which would set up a new, federally-assisted savings account for Americans.

I have been interested that, if we are going to move in that direction, that rather than set up a totally freestanding new set of savings vehicles, that we try to integrate that with the existing sav-

ings vehicles, both because it would appear to be more efficient, but also because it might serve as a stimulation for some of the particularly smaller employers who do not have employment plans now, if they knew that if they set up such plans that, in addition to what they might contribute, their employees might contribute, it would also receive some additional Federal support.

So I would be interested in your thoughts about the desirability of attempting to link new ideas for federally-assisted savings to existing savings plans, such as 401(k)s and IRAs.

Mr. PEARCE. Before we go forward with reinventing the wheel by the Federal Government, participating in a government-assisted savings program, I think that we have a system in place that is working to some degree, and could work much, much better if some of the rules that are fettering it down were liberalized. I think everyone on the panel here today has indicated various areas where they need to unfetter the private pension system so that it can better do the job that it is intended to do.

Ms. COMBS. We would agree with you. As far as the President's proposal and USA accounts, we would prefer to see those dollars used to expand and enhance the private pension system and individual savings rather than creating a new government entitlement program.

To the extent there are Federal incentives, use of surplus dollars to create incentives, we would rather see it integrated with the existing system. One idea we are discussing with our members, for instance, is maybe using a tax credit for employers to make matching contributions to simple 401(k) plans, to encourage them to be able to match those contributions, but to keep it in the private system where we think it will do the most good and be used most efficiently.

Mr. VALENTINO. NDCC fully supports that proposal. What we are looking for is to maximize utilization of the existing vehicles that we have as opposed to introducing a new vehicle. They work. They have become extraordinarily effective. They have been very successful and we need to encourage their utilization to keep the costs down of introducing these programs to the American population.

Mr. MACEY. And we would agree with that. Anything that can help the current system that is working well, expand the current system, and integrate the provisions for greater savings within that system, without imposing new burden requirements or recordkeeping burdens on it.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Well, thank you for being here today. It seems to me that two, maybe three things come out of these hearings: the need for transparency, the need for simplification of the various programs, and education.

Senator MOYNIHAN. Mr. Chairman, did we not learn that we need to have a special exemption for golf? [Laughter.]

The CHAIRMAN. What is your handicap? [Laughter.]

Thank you very much for being here.

The committee is in recess.

[Whereupon, at 12:05 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF ANN COMBS

Thank you, Mr. Chairman. I am Ann Combs, Vice President and Chief Pension Counsel for the American Council of Life Insurance. The Council is the major trade association of the life insurance industry, representing 493 life insurance companies. These companies hold 82% of all the assets of the United States life insurance companies and 83% of the pension business.

Mr. Chairman, you and the members of this Committee are to be commended for this timely hearing on an issue of extreme importance to the Nation. Years ago, Congress recognized the need to place primary reliance on private sector sources to assure the adequacy of retirement income. As a result, it encouraged employers and employees to use a voluntary private retirement system to supplement the economic protection offered by public programs such as Social Security. Since then, America has gone on to build a retirement system that is the envy of the world, and we are extremely proud to be a part of that system. The proposals we will be discussing today will further enhance the employer-based and private retirement savings systems.

The Council applauds your legislation, Mr. Chairman, S. 646, The Retirement Savings Opportunity Act of 1999, introduced with Senator Baucus. If adopted, this measure will help Americans save more for retirement in both private savings plans and employer-sponsored retirement plans. In addition, we commend Senators Grassley and Graham for S. 741, the Pension Coverage and Portability Act. We believe that these measures combined will increase both coverage of non-covered employees and expansion of existing retirement savings. These two pieces of legislation are being considered at a critical time; with the aging of the baby boom cohort, coupled with the uncertain future of government entitlement programs, including Social Security and Medicare, it is critical that voluntary employer-sponsored plans and individual savings be strengthened to meet the retirement security challenges of the 21st century.

The employer-sponsored system has been a tremendous success in ensuring current and future retirees' retirement security. Contrary to popular belief, the majority of current pension participants and recipients are not wealthy but rather middle-income Americans. According to 1997 Census Bureau data, 77 percent of pension participants have earnings below $50,000. These trends are similar for pension recipients. Among married couples, 70 percent of pension recipients had incomes below $50,000. Among widow(er)s, 55 percent of pension recipients had incomes below $25,000. When viewed in terms of pension dollars, over 50 percent of pension benefits go to elderly with adjusted gross incomes below $30,000. With additional incentives, simplification and expansion, this system will increase that security in terms of both the numbers of individuals covered as well as the amount of retirement income received. We believe the legislation we are discussing today, if enacted, will take significant steps in achieving these goals.

In particular, we would like to express our support for the following provisions:

(1) *Restoration of plan limits:* The legislation would increase the 401(k) and 403(b) pre-tax contribution limits from $10,000 to $15,000; 457 (b) plan pre-tax contribution limits from $8,000 to $12,000; SIMPLE plan limits would be raised from $6,000 to $10,000; and IRAs would be raised from $2,000 to $5,000. As the baby boom generation nears retirement, these increased limits will allow them to increase their retirement savings, thereby ensuring greater retirement security. While we enthusiastically support these provisions, we also urge you to similarly restore the defined benefit plans limits to their former levels.

(2) *"Catch up" contributions: We believe that allowing individuals to "catch up" their retirement contributions in later years, when other financial obligations have been satisfied, will only increase retirement security. This provision is especially helpful to working women who are the most likely to be in and out of the workforce during their younger working lives. Accordingly, we believe these "catch-up" contributions will greatly enhance savings opportunities for women. We strongly support this provision.*

(3) *Repeal of the 25% of Compensation Limit:* The repeal of the 25% of compensation cap will allow individuals to increase their retirement savings. This provision is particularly meaningful to middle-income individuals who are most likely to be subject to the cap. This provision will have a positive impact on small business where pension coverage is weakest. We also strongly support the similar relief for 403(b) plans and 457(b) plans that is provided in the legislation.

(4) *Repeal of the defined benefit full funding limitation:* Defined benefit plans provide retirement security and, in most cases, the guarantee of a lifetime stream of income. This is a very valuable benefit. However, the current liability full funding limit enacted in 1986 has hampered an employer's ability to steadily fund a plan over time. The repeal of this limit will ensure adequate funding over the life of the plan and will be particularly helpful in the small employer market. We strongly support its inclusion in the legislation.

(5) *Roth 401(k) and 403(b) plans:* Senator Roth's proposed legislation would allow individuals to contribute to their 401(k) or 403(b) plans on an after-tax basis, with the earnings on such contributions being tax-free when distributed, as is done in Roth IRAs. The Council believes that this proposal will give individuals greater flexibility in retirement planning, by allowing them to determine when they pay taxes on retirement savings. The Council supports this proposal.

There also are many provisions unique to the Graham/Grassley measure that we enthusiastically endorse. We list below a few provisions that member companies that market to the small business community believe will have the greatest impact on small business pension plan retention and expansion.

(6) *Modification of the Top Heavy Rules:* Top heavy rules apply to all qualified plans but they affect only small businesses. The Employee Benefits Research Institute's 1998 survey of small business reveals that the top heavy rules are one of the greatest regulatory disincentive to pension plan formation and retention by small businesses. In addition, subsequent to the adoption of the top heavy rules, many additional provisions have been enacted which provide broad safeguards for plan participants. As a result, the perceived need for these requirements is far outweighed by the fact that they serve as a significant barrier for small business plan expansion. We strongly support the provisions providing relief from some of the top heavy requirements. We would like to go further and see their outright repeal.

(7) *Additional Incentives for Small Employers:* In addition to several of the proposals outlined above which we believe will encourage small employers to establish plans, S. 741 contains other provisions that are designed specifically for small employers interested in establishing pension plans for their employees: (a) reduced PBGC premiums; (b) phase-in of additional premiums;(c) a tax credit for pension plan startup costs; and (d) the SAFE proposal establishing a defined benefit plan for small employers.

ACLI is committed to expanding pension coverage among small businesses. In addition to the items listed above, plan sponsors, particularly small employers who may not be able to hire plan consultants to offer advice on plans, need simplicity in plan design. Our member companies are exploring ways to further streamline the administrative burdens associated with plans designed for small businesses and discussing possible new plan designs that could be made available in addition to the SAFE proposal.

Finally, more Americans need to understand the importance not just of accumulating savings, but of planning to protect these savings against the uncertainties of what life might hold; uncertainties such as becoming disabled or a family provider dying early; uncertainties such as outliving one's income or needing long-term care. We should do more to encourage all Americans to accept the dual challenges of accumulating retirement savings and managing risks to these savings.

We need to adopt tax policies that reward responsibility and provide more flexibility for retirements that will be longer and very different from the past. The life insurance industry is the only private industry that can provide life insurance protection against leaving family members without money should a wage provider, childcare provider or homemaker die early; that can provide annuities which guar-

antee income for every month a person and his or her spouse lives, no matter how long; and that can protect a nest egg from being wiped out due to disabilities, or long-term care needs through disability and long-term care insurance. Senators Grassley and Graham have recognized the need to encourage Americans to protect against the costs of a long-term care episode by introducing S. 35, legislation that offers an above the line tax deduction for the costs of long-term care insurance premiums. We would also like to thank Senators Roth, Nickels, and Mack who recently included a similar proposal in their health care access bill, S. 1274. Accumulating savings for retirement is vitally important; protecting those savings before and in retirement is equally important. As leading providers of both accumulation and protection products, we are uniquely qualified to assist in developing strategies that will help Americans enjoy a secure retirement.

Again, we want to commend Chairman Roth, and the members of this committee for your recognition of the vital role that employer-sponsored plans play in the retirement security of this Nation. The voluntary employer-sponsored system not only needs to be maintained but expanded so that more individuals are covered and those individuals receive greater benefits. This legislation takes important steps in those directions. We encourage all members of this Committee to endorse the Roth/Baucus bill (S. 646) and the Grassley/Graham measure (S. 741) and to work for passage of this comprehensive pension legislation. Your efforts on behalf of these two bills will ensure the future retirement security of millions of Americans.

The Council looks forward to working with Chairman Roth and the Senate Finance Committee as they move forward in efforts to enact this vitally important pension reform legislation. Please feel free to contact us if we can provide any assistance in these efforts.

The Importance of Pension Benefits to Middle Income Retirees

For Senate Finance Committee Hearing
On Pension Reform Legislation
June 30, 1999

By Janemarie Mulvey, Ph.D.
Director, Economic Research

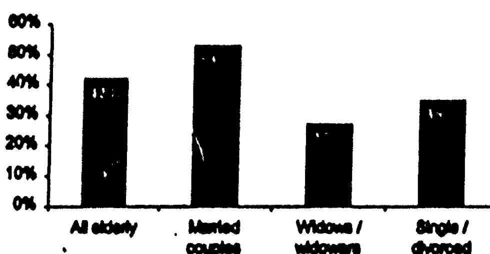
Purpose and Objectives

- Dispel the myth that pension benefits only accrue to upper income individuals
- Describe Pension Benefits Among Current Retirees
- Definition of Pension Benefits
  - Includes employer-sponsored plans, federal, state and local and military (does not include lump sum payments)
- Definition of Middle Income Retirees
  - Married couples with income between $30K to $50K
  - Widows/widowers with income between $15K to $25K

Over 40 Percent of the Elderly Receive A Pension Benefit

- **Recipients vary by marital status**
  - Over 50 percent of elderly married couples received pension income
  - Less than a third of widows/widowers received pension income
  - 35 percent of single/divorced received pension income

Percent Receiving Pension Benefits By Marital Status, 1997

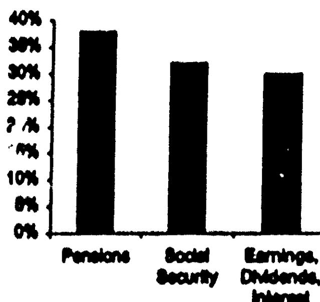


Source: ACLI analysis of 1998 Current Population Survey

For Pension Recipients, Pension Benefits Are Their Largest Source of Income

- Pension income comprised nearly 40 percent of income for those receiving a pension
- The average pension benefit was $10,000 in 1997
- The median pension benefit was $7,050 in 1997

Sources of Retirement Income For The Elderly, 1997

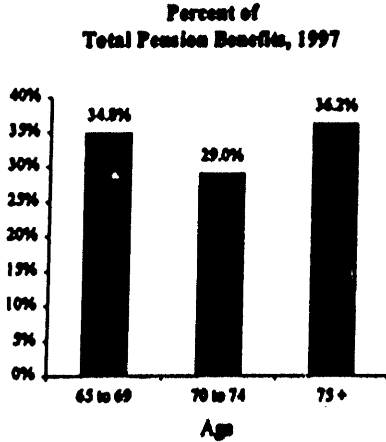


* Includes Veterans Benefits, Public Assistance and SSI.

Source: ACLI analysis of 1998 Current Population Survey

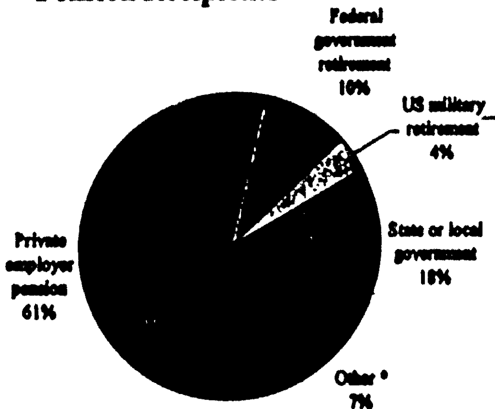
Distribution of Benefits by Age and Sex

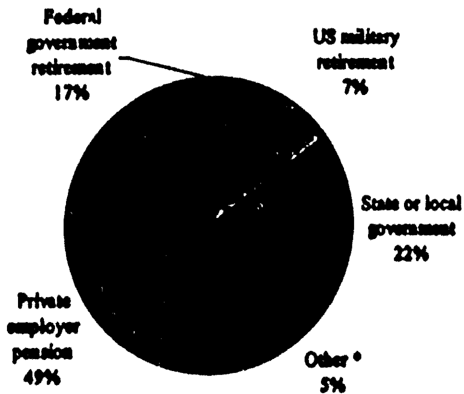
- The majority of pension benefits are concentrated among those aged 75 and older (36 percent)
- Elderly women are less likely to have a pension in their own name as compared to men -- sixty percent of elderly pension recipients are men



Source: ACLI analysis of 1998 Current Population Survey

Half of Pension Benefits Are From Private Employer Plans

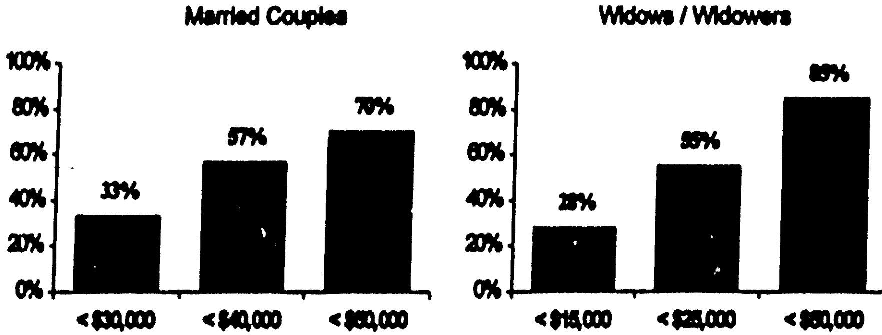




Source: ACLI analysis of 1998 Current Population Survey

Most Pension Recipients Are Middle Income

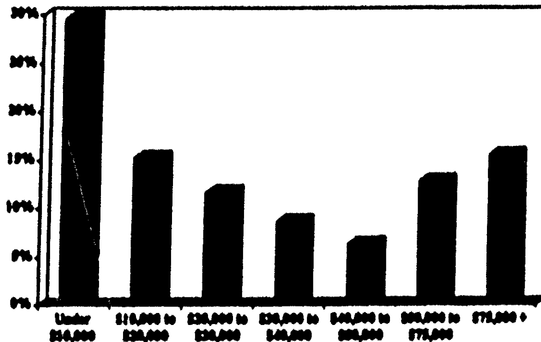
Pension Recipients By Income



Source: ACLI analysis of Current Population Survey.

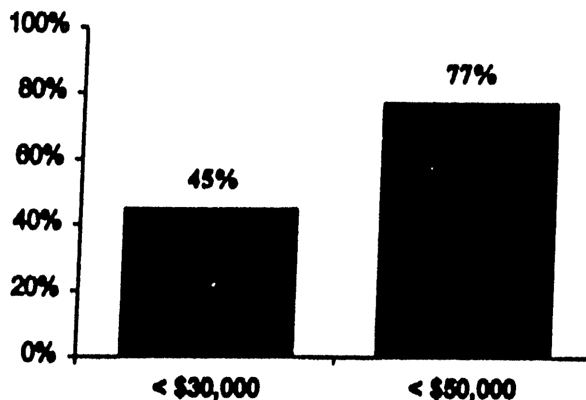
Over 50 Percent of Pension Benefits Go to Elderly With AGI Below $30,000

Percent of Pension Benefits by Adjusted Gross Income, 1997



Source: ACLI analysis of Current Population Survey.

Among Pension Plan Participants, Over 75 Percent Had Earnings Below $50,000



Source: ACLI analysis of 1996 Current Population Survey.

9

Conclusions

- Pension benefits are an important source of income to middle income elderly
- Key Points:
  - Among married couples nearly 70 percent of those receiving a pension had incomes below $50,000
  - Among widows/widowers over 55 percent of pension recipients had incomes below $25,000
  - Over 75 percent of current workers participating in a pension plan had earnings less than $50,000

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PREPARED STATEMENT OF HON. CHARLES E. GRASSLEY

Thank you Mr. Chairman for holding this hearing today. I want to commend Chairman Roth on his leadership in this issue. Not only has he developed legislation of his own, but this is the second hearing of the Finance Committee this Congress which examines issues of retirement savings and pension reform.

Ideally, pension benefits should comprise about a third of a retired worker's income. But pension benefits make up only about one-fifth of the income in elderly households. Obviously, workers are reaching retirement with too little income from an employer pension.

Workers who are planning for their retirement will need more pension income to make up for a lower Social Security benefit and to fit with longer life expectancies. While we have seen a small increase in the number of workers who are expected to receive a pension in retirement, only one half of our workforce is covered by a pension plan.

Yesterday, an article in the Wall Street Journal argued that tax-preferred savings vehicles, such as IRA's and 401(k)'s are ineffective. However, the article didn't address two important aspects which affect savings rates and participation in pension plans: education and pension leakage.

Savings education is a powerful influence on workers. According to the 1999 Retirement Confidence Survey by the Employee Benefit Research Institute, of those who received educational material from their employer 19% began saving; 21% resumed saving; 40% changed the amount they contributed to a retirement plan and 41% changed their asset allocation.

A second point which is important to make is the need to address leakage of pension money when employees change jobs. Roughly 60 percent of pension benefits are cashed out and used to purchase goods and services when employees changes jobs.

The lack of portability among plans is one of the weak links in our current pension system. Considerable savings are lost from the pension system and never have the opportunity to benefit from compound interest.

The Pension Coverage and Portability Act developed by Senator Graham and I and several members of this Committee contains proposals which would encourage retirement savings education and increase pension portability as well as expand coverage for small businesses, enhance fairness for women and families, strengthen pension security and enforcement, and reduce red tape.

Retirement security is a policy priority for both parties in this Congress and we have an obligation to work together to bring about real pension reform. Those of us at the policy tables can talk about the need for employees to prepare for retirement until we are blue in the face.

Unless we give them and their employees the tools to build a better retirement nest egg, policy makers should be prepared to address even bigger challenges when retirees realize the hard way that their retirement income falls short when they need it most.

We have a window of opportunity to act. It is likely that future retirees will not be able to rely on all of the benefits now provided by Social Security.

We can look to the pension system to pick up where Social Security leaves off, but Congress needs to clear the thicket of rules governing private pension plans. The system doesn't address the changing structure of today's workforce and leaves too many workers uncovered.

There is considerable bipartisan support for pension reform and for the means by which to achieve it. We need to act on pension reform because it plays a critical role in providing the financial security and peace of mind during one's retirement years. Unfortunately, I cannot stay to hear the witnesses today, however I look forward to reading their testimony.

Attachment.

Less Than Zero

Few Americans Heed Washington's Urging For Bigger Nest Eggs

Savings Rate Declines Again As Tax Breaks, Caveats Collide With Prosperity

Raiding 401(k) for a Dream

By Jacob M. Schlesinger
Staff Reporter of The Wall Street Journal

WASHINGTON – For a quarter century, politicians have been tinkering with the tax code and otherwise creating incentives to encourage people to save. Yet Americans have only become more profligate.

In 1974, the year Congress created the Individual Retirement Account, Americans saved 9.5% of their paychecks. These days, Americans are spending everything they make, and then some. Yesterday, the Commerce Department said the official household savings rate in May fell to minus 1.2%, the lowest level since the Great Depression.

The almost universal response from Washington: Keep trying. President Clinton wants to create "universal savings accounts" in which the government would match middle-class families' savings. The Republican chairman of the Senate Finance Committee wants to sweeten tax breaks for IRAs and employer-sponsored savings programs known as 401(k) plans. And Congress has begun debating whether some portion of the Social Security system should be turned over to private savings accounts that Americans would control.

Big Spenders

The Commerce Department said spending rose 0.6% in May, as personal income, before adjusting for inflation, grew 0.4% during the month. Article on page A2.

If the past is any guide, these efforts may prove futile. While academics debate the effects of previous savings incentives, this much is clear: The personal-savings rate – the percentage of household income not consumed – has continued to decline, even as government "incentives" to save have multiplied.

Many Americans, it seems, fall into one of two camps, neither of which is easily swayed by policy changes. The members of one group refuse to tuck away funds, no matter what inducements they're given. Charlotte Garrett, a secretary in Franklinton, La., could exempt from taxes up to $2,000 of her annual salary by putting it in an IRA. But the 43-year-old mother of three doesn't put in a dime. And it isn't because she can't afford it. She jokingly labels the $150 she spends each month at nearby casinos "my IRA money." After each gambling trip, "I think, 'I should have put that into some type of savings,'" she says. "But then you'd go nuts. This is a small town with nothing to do."

Then there are the people who do save, even without a prod from the government. They welcome tax breaks for savings. But they don't save more as a result – they just shift their savings around to get the tax break. Bill Brecht, 38, says he "wants to retire at 55, and I understand what that's going to take." So he aims to save each year about $20,000 of his $75,000 salary. As part of that, he stuffs as much money as the law allows into the 401(k) plan of his employer, a Lancaster, Pa., printer – and would put in more if Congress let him. But he says he wouldn't increase his overall savings – he would just raid one of his taxable accounts. "I'm a pretty frugal guy already," he says.

Building Tax Shelters

Indeed, when banks and brokerage firms market savings incentives, they often sell them as tax shelters. In promotional material, Fidelity Investments, the mutual fund giant that manages corporate 401(k) plans, explains how such plans can help you spend more money. Sticking $3,000 in the tax-deferred plan can "increase your take-home pay" by $840, it explains, if you shift the money from "a taxable account outside the plan," such as a regular savings account.

So why do politicians keep pushing tax breaks for savings?

First, proposing tax breaks for savings is as popular as anything Congress does. No matter if it doesn't work; constituents don't complain.

Second, the banner of "savings promotion" offers cover for efforts to provide a tax cut to the largely affluent, and largely Republican, Americans who do most of the nation's saving.

Good for the Economy

And third, the financial-services industry, which makes big fees from the tax-free accounts, lobbies heavily for more savings breaks. Much of the material circulating on Capitol Hill justifying expanded IRAs was written by the "Savings Coalition of America," formed in 1991 by brokerage firms and their trade associations. The group spent $219,268 on lobbying in 1997, the last full year for which such data are available, according to the Center for Responsive Politics, a Washington organization that tracks lobbying and campaign contributions. One of the coalition's leading members, Merrill Lynch & Co., has taken out full-page newspaper ads backing efforts to expand the IRA, headlined "Saving America from a savings crisis."

"Obviously Merrill and Fidelity and others market and sell a lot of IRAs and collect fees on that," says Bill Dereuter, Merrill Lynch's vice president for government relations. "We have the luxury," he

Please Turn to Page A6, Column 1

Americans Resist Savings Push

Continued From First Page

adds, of linking the firm's self-interest with "advocating increased personal savings, which any economist will argue is good for the economy."

Actually, economists are divided over whether America even faces the "savings crisis" that has become conventional wisdom in Washington.

Those who are concerned about low savings say the problem can, theoretically, limit the economy's long-term growth. The amount of money households save affects the pool of funds American companies have to invest, which in turn influences the economy's long-run efficiency and living standards—or so the argument goes. Yet the U.S. economy has thrived in the 1990s, while thrifty countries like Japan and Germany have floundered.

That's partly because foreigners are willing to inject investment capital into the U.S. economy. Moreover, while American families have become less thrifty, the federal government has become more so. Just yesterday, the White House announced projections of huge budget surpluses in the years ahead—$1 trillion higher over the next 15 years than projected just five months ago. That will increase national savings and ease any damage done to the economy's health by the low level of personal savings.

A rising stock market has also helped diminish the burden that a low savings rate poses to individual households. The Commerce Department's savings figures only count income that is set aside for savings—they don't include the rapidly rising value of stock portfolios. But clearly, even if Americans are spending all their income, the bull market has increased the value of their savings.

Advocates of tax breaks for savings argue that decisions on how much to save are affected by cost. And right now, they complain, savings are overtaxed. Money saved gets taxed when it is earned, and then the earnings on those savings are later taxed as well. Reducing the tax burden, they insist, should encourage people to save more.

"It's a powerful motivator," says Lynn Ballou, a Northern California financial adviser. "People usually come to me after their accountant yelled at them at tax time" and urged them to lower their tax bill through 401(k)s. Once her clients put money into the plans, she says they do boost their savings rate—if not by cutting spending, then by putting in their raises "and not ratcheting up their standard of living."

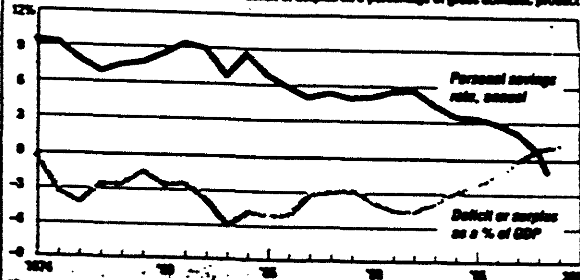
Incentive backers also argue that expanding IRAs and 401(k)s would lead to a sharp expansion of advertising and financial-press coverage for those products—and that the added buzz would catch the eye, and change the behavior, of many Americans.

But clearly the tax breaks don't work as much as they could. One-fifth of workers eligible for 401(k) plans, for example, don't contribute to them at all, according to the Spectrem Group, a San Francisco-based consulting firm that studies 401(k) patterns. Of those people who do contribute, roughly two-thirds don't give the maximum. A separate survey by the Washington-based Employee Benefit Research Institute showed that fewer than 10% of those eligible to contribute to standard IRAs choose to do so.

The reasons Americans don't save more are complex, ranging from lack of knowledge about the financial vehicles and their benefits, to a popular culture that glamorizes consumption.

Many families are strapped despite the good times, and simply don't have enough money. "Right now I'm at the limit," says Donna Bradford, a 45-year-old inspector at a Georgia yarn factory. She contributes only about half of the maximum allowed to her 401(k), and a higher tax break wouldn't change that. "I've got two kids in school, one in college, and I just can't afford more," she says.

There is also an ingrained cultural streak—call it a reckless optimism, or a willingness to take risks—that leads Americans to salt away less than, say, the Japanese. No tinkering with the tax code is going to engineer a national personality



As the Government Saves, the People Spend

U.S. household* savings rate and federal deficit or surplus as a percentage of gross domestic product

transformation.

Bibi Qualls-Valenzuela, a Florida music teacher, is 60 years old and joyfully admits that "I don't have any money" stashed in an IRA or even a savings account. But she isn't too worried about her future. "I plan in five years not to be where I am today," financially.

How? Ms. Qualls-Valenzuela buys lottery tickets every week. She has got some books about "how you can buy houses for nothing down and amass a lot of money." She is contemplating selling her house and "investing in heating oil, and options like gold, platinum and stuff like that." She admits she could cut back on eating out or going shopping, "but what else am I going to do?" she asks. "I don't drink. I don't smoke. I don't date. Shopping is what I enjoy—it's like a hunger for me."

Joseph L. Jones is one of America's dissavers. He is 47—a time of life, the experts intone, for preparing for retirement. Yet Mr. Jones has pulled $30,000 out of his IRA in recent years, even incurring the penalties, to help pay for his dream of expanding the Cleveland remodeling and construction business he founded five years ago. His business is growing quickly, and he thinks he will strike it rich. "The worst case is I'll

get totally wiped up," he says, "but I'm capable of starting over again."

Saving too much, Mr. Jones opines, is practically un-American. "In a lot of countries, there's fear, and fear of what happens makes you save for that proverbial rainy day," he says. "In America, there's hope – that sunshine of opportunity."

Among those Americans who do save, many have a set target for how much money they'd like to accumulate by retirement. For them, the booming stock market is likely to discourage savings. And tax breaks for savings, ironically, can have the same effect, because they lower the amount of money you need to salt away to reach your goal.

A recent report prepared by Congress's Joint Committee on Taxation notes, for instance, that an upper-middle-income family who wanted to accumulate $3,000 over the next 15 years in a taxable savings account, would need to put away $1,300 today to meet that goal. But if they used a Roth IRA, which allows the gains to accumulate tax-free, they'd need to put away only $946.

The American urge to splurge is such that many people find ways to keep spending even as they save – by borrowing money to take advantage of the federal savings incentives while maintaining their current living standards. After all, the rise in contributions to 401(k) plans over the past two decades has coincided with a sharp increase in household debt. A recent study by Brookings Institution economist William Gale and Federal Reserve Board economist Eric Engen concluded that 401(k) contributions are "generally offset by reductions in housing equity and in particular by increases in mortgage debt."

Their paper begins by quoting a radio advertisement run by Cleveland-based KeyBank pushing its home-equity loans. Noting that some financial advisers suggest boosting savings for retirement, the announcer asks, "but doesn't that involve giving up money right now?" The punch line: "Good thing Key has come up with their own formula: Save money by borrowing money."

At the same time that Daphne Harris was dutifully putting 10% of her salary into her 401(k), she was racking up $20,000 in credit-card debts. "I liked to spend and I didn't want to take down my 401(k) contributions," says the manager of a New Jersey leasing company. (Now, she says she has consolidated her debts and stopped using her credit cards.) . . .

In what sounds paradoxical, many 401(k) plans allow participants to borrow directly against them; and 18% of those eligible exploit the offer, according to the Employee Benefit Research Institute. The average borrower has a loan outstanding worth one-sixth of the "savings" he has accumulated.

Robert Lawlor, a West Paterson, N.J., accountant, regularly advises his clients to borrow this way. "People ask, 'Why should I put money into a 401(k) plan if I need to buy something?' " he says. His answer: "You can pay less taxes through a 401(k) contribution, and go ahead and borrow the same money on a home-equity loan."

There's another reason Americans may hesitate to listen to Washington on savings: Many don't believe the politicians. For a savings tax break to encourage greater savings, people have to understand it and to think it won't be taken away. But the complex rules governing who qualifies for a Roth IRA – the newest savings break adopted in 1997 – are giving fits to financial planners.

And many taxpayers remember how Congress expanded the breaks for IRAs in the early 1980s – then curbed the advantage in 1986. "From a consumer's point of view, the bottom line is that, what the government gives, the government will take away," says Malcolm Makin, a Rhode Island financial adviser. "There tends to be a general distrust of these types of things," he adds.

PREPARED STATEMENT OF HON. TOM HARKIN

Mr. Chairman. Older workers across America have been paying into pension plans throughout their working years, anticipating the secure retirement which is their due. And now, as more Americans than ever before in history approach retirement, we are seeing a disturbing trend by employers to cut their pension benefits.

Many companies are changing to so-called "cash balance" plans which often saves them millions of dollars in pension costs each year by taking a substantial cut out of employee pensions. This practice allows employers to unfairly profit at the expense of retirees.

Employees generally receive three types of benefits for working: direct wages, health benefits and pensions. Two of those are long-term benefits which usually grow in value as workers become older. Pensions are paid entirely after a worker leaves. Reducing an employee's pension years after it is earned should be no more legal than denying a worker wages after work has been done.

In fact, our laws do prohibit employers from directly reducing an employee's pension accrued benefit. Unfortunately, however, these protections are being sidestepped and workers' pensions are being indirectly reduced through the creation of cash balance pension plans.

Under traditional defined benefit plans, a worker's pension is based on their length of employment and their average pay during their last years of service. Their pension is based on a preset formula using those key factors rather than the amount in their pension account. Under the typical cash balance plan, a worker's pension is based on the sum placed in the employee's account. That sum is based on their wages or salary year to year.

When a worker shifts from a traditional to a cash balance plan, the employer calculates the value of the benefits they have accrued under the old plan. The result for many older workers who have accrued significant sums in their pension that are higher than it would have been under the new cash balance plan. In that case, under many of these cash balance plans the employer simply stops contributing to the value of their pension till the value reaches the level provided for under the new plan. And this can go on for significant periods—five years and sometimes more. Pension experts call this "wear away" others call it a "plateau."

This is not right. It is not fair. In fact, I believe it is a type of age discrimination. After all a new employee, usually younger, would effectively be receiving greater pay for the same work: money put into their pension plan. And, there are some who believe this practice violates the spirit and perhaps the letter of existing law in that regard.

What does this mean to real people?

Two Chase Manhattan banking executives hired an actuary to calculate their future pensions after Chase Manhattan's predecessor, Chemical Bank, converted to a cash balance plan. The actuary estimated their future pensions had fallen 45%. John Healy, one of the executives, says, "I would have had to work about ten more years before I broke even."

Ispat Inland, Inc, an East Chicago steel company, converted to a cash balance plan January 1. Paul Schroeder, a 44-year old engineer who has worked for Ispat for 19 years, calculated it could take him as long as 13 years to acquire additional benefits.

Why are companies changing to these cash balance plans? They have lots of stated reasons: ease of administration, certainty in how much is needed to pay for the pension plan and that the plan is beneficial to those workers who move from company to company with similar pension plans. But, the big reason is the companies save millions of dollars. They save it because the pensions provided for with almost all cash balance plans are, on average far less generous, and they often immediately reduce their need to pay anything into a pension plan at all for a while, sometimes for years, because of this wear away or plateau feature.

At one conference of consulting actuaries, Joseph M. Edmonds told companies:

> " . . . it is easy to install a cash balance plan in place of a traditional defined benefit plan and cover up cutbacks in future benefit accruals. For example, you might change from a final average pay formula to a career average pay formula. The employee is very excited about this because he now has an annual account balance instead of an obscure future monthly benefit. The employee does not realize the implications of the loss of future benefits in the final pay plan. Another example of a reduction in future accruals could be in the elimination of early retirement subsidies."

Because traditional pension plans become significantly more valuable in the last years before retirement, the switch to cash balance plans also can reduce older workers' incentive to stay until they reach their normal retirement age.

I support Senator Moynihan's legislation that requires that individuals receive clear individualized notice of what a conversion to a cash balance plan would do to their specific pension. There is no question that shining the light on this dark practice can reduce the chance that it will occur. I certainly agree with his view that those notices should not be generalized where obfuscation is easier and employees will pay less attention to the result.

I also believe that more must be done. For that reason, I introduced S 1300, the "Older Workers Pension Protection Act of 1999" which prohibits the practice of "wear away." It provides that a company cannot discriminate against longtime workers by not putting aside money into their pension account without any consideration for the long term payments made to the employee's pension for earlier work performed. Under my bill, there would be no wear away, no plateau in which a worker would be receiving no increases in pension benefits while working when other employees received benefits. The new payments would have to at least equal the payments made under the revised pension plan without any regard to how much a worker had accrued in pension benefits under the old plan.

Some suggest that if such a requirement were put in place, companies could and would opt out of providing any pension at all. I do not believe that would happen. Companies with defined benefit plans do not have them because they are required to do so. They do it because of negotiated contracts or because the company has decided that it is an important part of the benefits for employees to acquire and maintain a productive workforce. Many suggest that the simple disclosure alone might prevent a reduction in payment benefits.

Much is made about the gains of younger workers when companies switch to cash benefit plans. There is greater portability. But, none of the experts I've consulted believe that is a dominant motivation of the companies for proposing these changes in pension law. And, the changes I am proposing would not reduce the benefits for younger workers.

I urge the Committee to take a fresh look at the spirit of the current law that prevents a reduction in accrued pension benefits. I believe it is only fair to extend that law with its current spirit, by simply requiring that any company which changes to a cash balance or similar pension plan, treats all workers fairly by and not penalize older employees whose hard work has earned them benefits they under the earlier pension plan.

PREPARED STATEMENT OF HON. ORRIN G. HATCH

I commend the Chairman for holding this hearing today. Retirement security is a topic that is on everyone's mind these days. Whether the topic is the future of Social Security, the expansion of private pension coverage, or the sharp decline in the savings rate, people are starting to think about the future and how secure their own retirements are going to be. Having recently turned 65, 1 find myself more tuned in to these issues on a personal level as well.

The savings rate in this country has sharply declined in the last 25 years. In 1974, when we created IRAs, the average American saved 9.5% of their income. Last year, that same American saved only 1/2 of 1 percent, the lowest level since the Great Depression of the 1930s.

Why do we care about the falling savings rate? What does it really mean? To an individual American, inadequate savings now will lead to a retirement crisis later down the road. To the nation as a whole, low savings rates will lead to higher interest rates and slower economic growth.

Why are savings rates falling at a time when economic growth appears to be so strong? There are many things that contribute to the current savings shortfall. One obvious place we can look is the Internal Revenue Code. The complex rules surrounding retirement savings are enough to make anyone think twice before getting into them. Add to that the fact that we continue to penalize savings and investment. This is the wrong message to send to the American people. We should be enacting simple laws with few restrictions to encourage everyone to save as much as possible.

The story does not end there. We must also look at access to private pension plans as well. The American workplace is changing. Gone are the days when a worker would spend his entire career with one or perhaps two companies. We now see a work force that is characterized by workers moving from company to company. Americans are living longer and having fewer children. The average American today will spend 1/3 of their lifetime in retirement.

Despite this, we find that many people still have no access to, or choose not to participate in, a private pension plan. This problem is particularly glaring for small business. Only 1 in 5 Americans working for small business has access to pension

plans through their employer. Cumbersome pension rules act as a disincentive to all businesses—large and small—to offer a pension plan and scare off employees that might otherwise participate

The need for better retirement security has never been greater. It is not enough for Congress to talk about the need for employees to accept significant personal responsibility in preparing for retirement. We have to give them the tools to do it through simplifying the rules, reducing the tax burden on those who save, increasing pension portability, and expanding small business coverage.

The legislation we will discuss today moves us a step forward in giving the American people the tools and incentives to prepare for retirement. I look forward to the discussion here today and welcome the witnesses who will testify.

Thank you Mr. Chairman.

PREPARED STATEMENT OF ROBERT F. HILL

Chairman Roth, Senator Moynihan, members of the Committee, thank you for the invitation to testify today. My name is Robert F. Hill and I am an attorney in private practice in Denver, Colorado. Along with my co-counsel, William Carr, I represent employees of two companies, Onan Corporation and Furrs'/Bishop's Cafeterias, in class action lawsuits raising issues regarding their conversions to cash balance plans.

I am here today to discuss the need for greater disclosure when pension plans reduce benefits to existing employees by changing to cash balance and other hybrid plans and to endorse the Pension Right to Know Act of 1999 as a very moderate and balanced response to these very serious problems.

Based on our experiences with employees of dozens of companies that have switched to cash balance plans, it is clear that additional disclosure is absolutely essential if our workforce is to make rational judgments in planning for their future. This problem is particularly acute when companies switch to cash balance plans because of the difficulty employees have in comparing the benefits that they would have received under the previously existing traditional defined benefit plan and the benefits they will receive under the newly adopted cash balance plan.

These are not academic issues. These are bread and butter issues for the millions and millions of American workers impacted by the changes to cash balance pension plans. While an employer has a legal right to change its pension plan, it is essential that employees be provided sufficient information to make informed decisions regarding their future employment and retirement plans. In fact, it is absolutely essential that they have this minimal information in time to make informed career choices and to plan for their future retirement.

As part of our research of cash balance plans, my co-counsel, Mr. Carr, reviewed transcripts and tape recordings of hours and hours of discussions regarding cash balance plans among the professionals who are drafting and implementing these cash balance plans for some of the nation's largest employers. We wanted to find out what these professionals were saying about cash balance plans when they were talking to each other, as opposed to what they were saying in their press releases and presentations to Congress. The results of that research was dramatic and unmistakable.

(I have attached to this written statement several exhibits which set forth in detail the context, date and source of each of the quotations I reference in this statement.)

First, these cash balance professionals uniformly agreed that "it is difficult for employees to compare prior pension benefit formulas to the cash balance approach." (Exhibit 1). Because there is "little comparison that can be done between the two plans," conversion to a cash balance plan can be used to "mask" benefit reductions. (Exhibit 2).

In fact, one of the benefits that the advocates of cash balance plans repeatedly touted was the fact that the conversion to a cash balance plan could be used to "mask a benefit cutback." (Exhibit 3). As one professional informed his colleagues at a meeting of the Conference of Consulting Actuaries, "it is easy to install a cash balance plan in place of a traditional defined benefit plan and cover up cutbacks in future benefit accruals." (Exhibit 4). More recently, one prominent actuary advised his colleagues at a meeting of the Society of Actuaries that cash balance plans can be used to "facilitate benefit changes"—you can change to a totally different type of plan "without being obvious about it." (Exhibit 5).

The impact of this type of artifice on the lives of the older employees is devastating. As one recognized authority on cash balance plans observed last year at a national meeting of the Enrolled Actuaries, "I've been involved in cash balance

plans five or six years . . . and what I have found is that while the employees understand it, it is not until they are actually ready to retire that they understand how little they are actually getting." Another professional on that panel immediately concurred, "Right, but they're happy while they're employed." (Exhibit 6).

Even if one ignores the cynicism reflected by those comments as well as the laughter that is clearly audible from the audience when those comments were made, those statements graphically demonstrate the need for certain minimal disclosure. Disclosure that is not currently required and disclosure that is all too often not currently being provided.

The current disclosure requirement under 204(h) of ERISA is totally inadequate to meet the needs of employees trying to plan for their future. As the cash balance professionals repeatedly have emphasized, "a 204(h) Notice doesn't require you to say that we're significantly lowering your benefit. All it says is describe the Amendment. So you describe the Amendment." (Exhibit 7). Or, as another cash balance expert put it, "[s]ince the Notice requirement doesn't have to include the words that your rate of benefit accrual is being reduced, you don't have to say those magic words." (Exhibit 8). Unfortunately, the tragic result of failing to provide even the most basic information to employees all too often results in them being unaware of the dramatic impact on them of the conversion to a cash balance plan until they retire.

By the time employees retire, it is too late for them to act on this information. By then they do not have the option to switch employers, increase their rate of savings or otherwise provide financial security for their remaining years. And both the unfortunate employees and society in general are left holding the bag.

Based on what we have learned regarding both the use of cash balance plans and the painful impact such plans are having on millions of employees, it is clear that greater disclosure regarding pension changes is needed. And such disclosure must be understandable. It must be provided in a format that can be understood by the average employee and used by the average employee to make informed decisions regarding his or her future employment and retirement plans.

The objections raised by opponents of the Pension Right to Know Act of 1999 are not well founded. First, it is extremely important to note that responsible employers are already providing disclosure of the type required by the Act. In fact, some employers are already providing more detailed disclosure than would be required by the Act.

The most frequently voiced arguments in opposition to the Act do not withstand close scrutiny. First, some object that providing individualized information will be excessively burdensome. However, this ignores the fact that by its very nature the conversion to a cash balance plan requires the employer to make an individualized calculation of the opening account balance of each employee and existing law requires the employer to provide a benefit that is no less than what the employee had earned before the conversion. Thus, as a practical matter, individualized calculations are already being prepared in the context of these conversions.

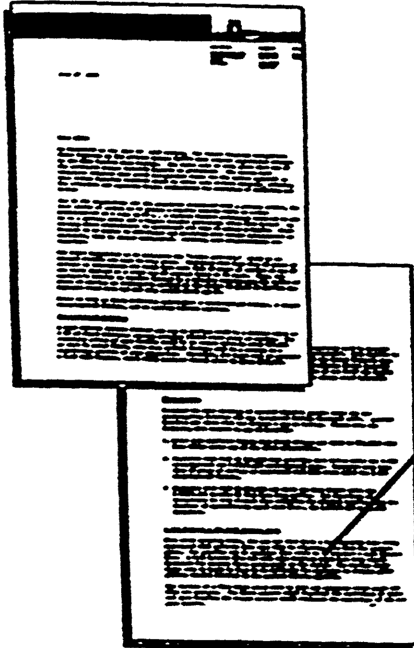
It also has been suggested that a comparison between the old benefits and the new benefits will be misleading to employees. While certain assumptions are inherent in any future projection, that hardly makes such a comparison misleading so long as the assumptions are reasonable and disclosed. Certainly no employer would make a decision to change to a cash balance plan without projecting the cost of the change using methodologies and assumptions similar to what the Act would require. If these type of calculations are sufficiently reliable for employers to use in making corporate planning decisions, why are they not sufficiently reliable for employees to use in making individual planning decisions?

Finally, it should be noted that most employers have routinely provided some method for employees to obtain an estimate of their benefits under the traditional plans and most now provide a similar mechanism to estimate benefits under the cash balance plan. What the Act requires, and what seems most objectionable to some, is that the employees will be allowed to compare the benefits under each. That, of course, is precisely what is needed to avoid the masking of benefit reductions and to permit employees to make informed decisions regarding their future.

And that is precisely why it is so important that disclosure of the type required under the Pension Right to Know Act be implemented. Thank you very much for permitting me to testify today. I would be pleased to answer any questions that any members of the Committee might wish to ask.

ABC COMPANY LETTER TO 1-2-3 CORPORATION

JULY 27, 1989

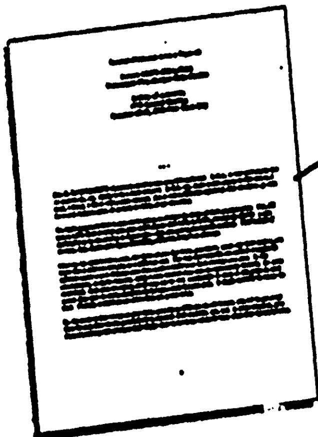


"A Cash Balance Plan has many nice features which have been widely discussed (we enclose three newsletters on the topic). One feature which might come in handy is that it is difficult for employees to compare prior pension benefit formulas to the cash balance approach."

EXHIBIT 1

SOCIETY OF ACTUARIES

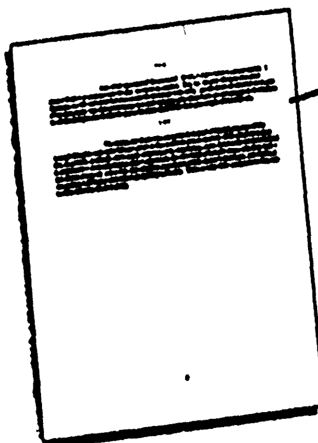
OCTOBER 18-23, 1998



MR. A

"The basic approach here is that we're going to change the form of their pension plan. Yes, if I have a 1.0% final average pay plan and I reduce that 1.0% to 0.8%, everybody knows – you don't have to be an actuary to figure out – that you just had a benefit cutback. That's kind of obvious. Um, if you give them something different, it isn't as obvious."

"So, the point is that we try to give them something different to, obviously, um, try to get away from the fact that we are gonna have to cut back their benefits, um, and, in some respects, give them something that perhaps they might view to be more valuable than what they currently have."



MR. B

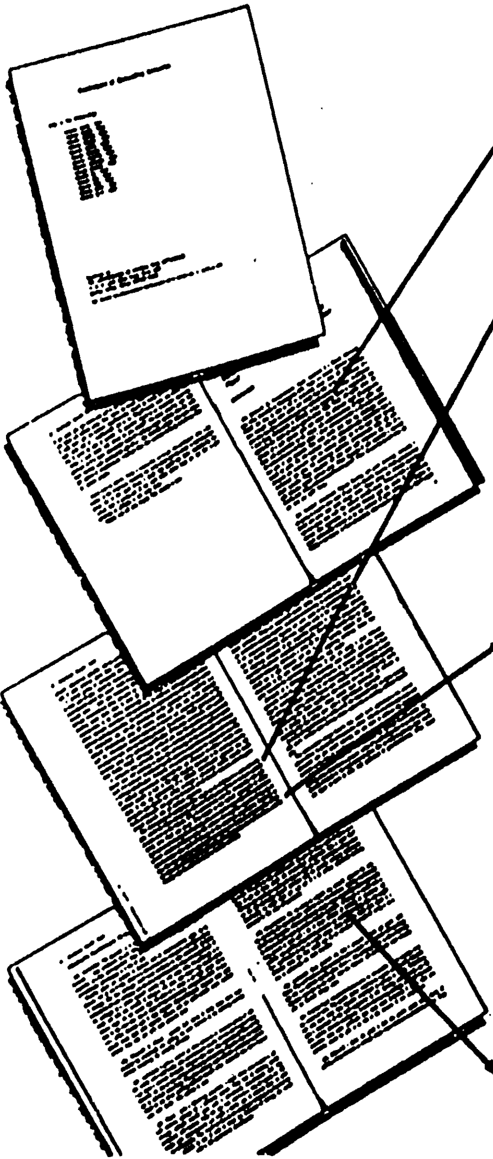
"But, let me just discuss two plan redesigns we did and cash balance could be involved with both. As Ira kind of alluded to in one of his comments was that converting to a cash balance plan does have an advantage of it masks a lot of the changes and it allows you a lot more flexibility than you might otherwise see."

"The reason for these two examples is it kind of highlights one of the original thoughts with cash balance plans is that it allows you to convert other plans to a plan that, in general, is simply more easily understood by employees, more frequently communicated to employees – most employees didn't appreciate the two defined benefit plans that they had – and allows you to do it in a way which allows a conversion which doesn't highlight, you know, I was getting 1.25% of pay and now I am getting 1.00% of pay. There is very little comparison that can be done between the two plans."

EXHIBIT 2

CONFERENCE OF CONSULTING ACTUARIES

1986



MR. C ...the expert in the world on these type of plans."

"The third group of companies that ought to be looking at a cash balance plan would be those companies that are looking to reduce or at least control pension cost in the future"

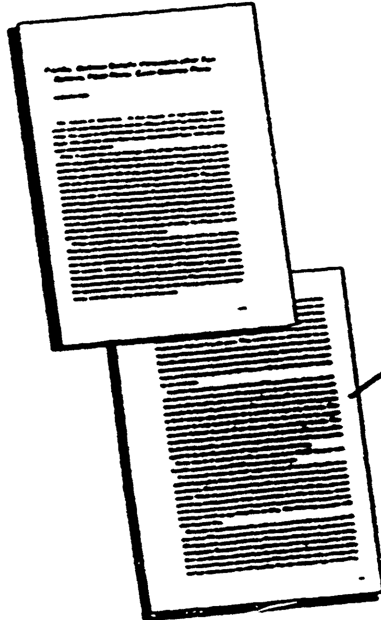
"The switch to the hybrid approach in effect represents converting the final pay plan to a career pay plan with its inherent greater control of future costs but without the negative aspects of having to communicate that kind of change to the employee population. Needless to say, the way the plan is presented to employees looks so dramatically different than the defined benefit plan that the employees are used to that, and the change can be used to mask a benefit cutback."

"Earlier I indicated one of the situations where a company might want to consider this approach is when it can be used to mask a benefit cutback."

EXHIBIT 3

CONFERENCE OF CONSULTING ACTUARIES

1987



MR. D

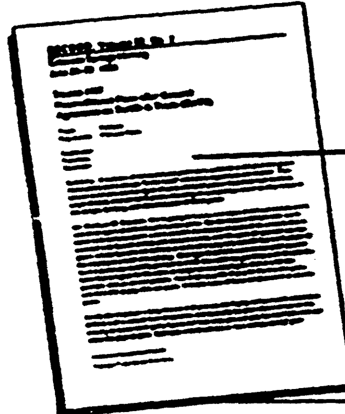
"...it is easy to install a cash balance plan in place of a traditional defined benefit plan and cover up cutbacks in future benefit accruals. For example you might change from a final average pay formula to a career average pay formula. The employee is very excited about this because he now has an annual account balance instead of an obscure future monthly benefit. The employee does not realize the implications of the loss of future benefits in the final pay plan. Another example of a reduction in future accruals could be in the elimination of early retirement subsidies."

EXHIBIT 4

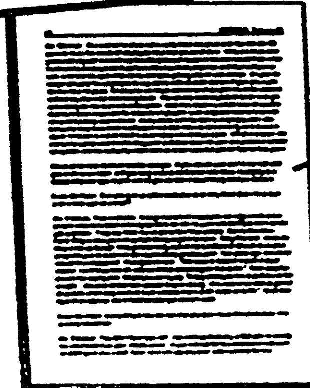
61-789 00 - 3

SOCIETY OF ACTUARIES

JUNE 26-28, 1996



MR. E

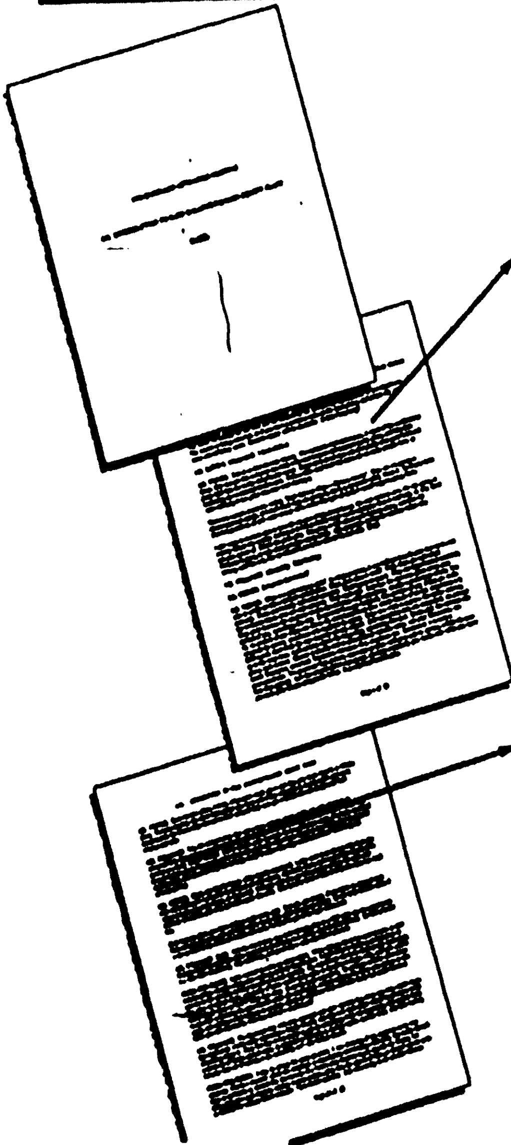


"These plans help facilitate benefit changes. If you decide your plan's too rich and you want to cut back, and you only want to do that for new hires, changing to a totally different type of plan will let you do that without being obvious about it."

EXHIBIT 5

ENROLLED ACTUARIES MEETING

1998



MS. F This is an introductory lecture. We wanted to have it because, at most of the conferences lately, they assume that everyone has dealt with cash balance and pension equity plans, and they just jump right into the really complicated issues. If you have never seen one it is pretty over your head and confusing,..."

MR. G

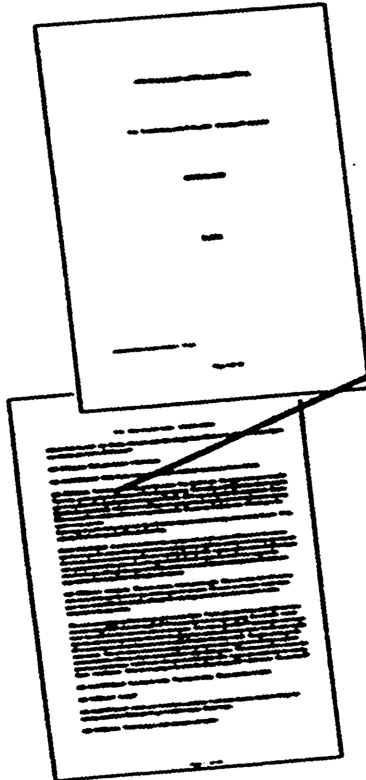
I've been involved in cash balance plans five or six years down the road and what I have found is that while the employees understand it, it is not until they are actually ready to retire that they understand how little they are actually getting."

MS. F. Right, but they're happy while they're employed."

EXHIBIT 6

ENROLLED ACTUARIES MEETING

1998



MR. H

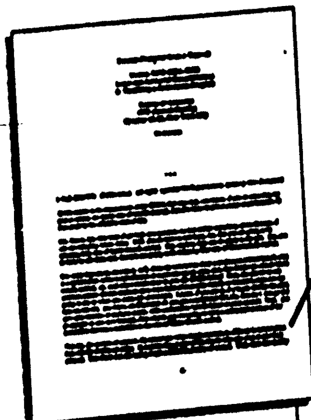
Remember, a 204(h) notice doesn't require you to say that we're significantly lowering your benefit. All it says is describe the amendment. So you describe the amendment."

EXHIBIT 7

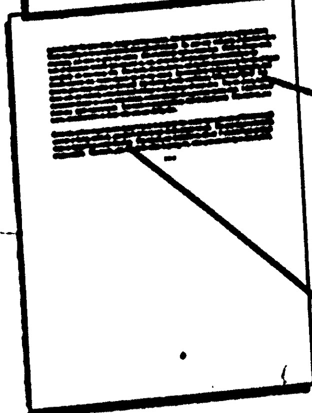
SOCIETY OF ACTUARIES

OCTOBER 18-23, 1998

MR. I



"...the economic value that is accrued, is different in hybrid plans than it is for traditional plans. In essence that is part of the reason why you want to put these plans in. You know you are trying to get a different pattern of accrual. Well, what that usually means is that for your older, longer service workers, that their rate of accrual is going to go down. There is going to be a reduction in their rate of accrual."



"So everybody is trying to figure out, do I have to give them notice or do I not? My answer is very consistent: Who cares? Do it!"

"Since the notice requirement doesn't have to include the words that your rate of future benefit accrual is being reduced, you don't have to say those magic words. You just have to describe what is happening under the plan. You know, my response is: Do it! I wouldn't put in those magic words."

EXHIBIT 8

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July 15, 1999

VIA FEDERAL EXPRESS

William F. Sweetnam, Jr.
Tax Counsel
United States Senate
Committee on Finance
Dirksen Building, Room 219
Washington, D.C. 20510

Dear Mr. Sweetnam:

I am writing in response to your letter of July 2, 1999, requesting my thoughts regarding certain questions and comments from Chairman Roth. Unfortunately, as I advised you in our telephone conversation Tuesday, I did not receive your letter until July 12 and I have prepared this response as promptly as circumstances permitted. Consistent with both my oral and written testimony before the Committee earlier this month, I believe the record is clear that there is a dire need for legislation requiring meaningful disclosure when an employer changes its pension plan benefits to the detriment of its employees. Against that factual background, I will address each of the three questions posed by Chairman Roth in your July 2, 1999 letter.

QUESTION

Mr. Hill advocated that employees should have individualized statements on what their benefit would have been under the old plan. My question is will the detailed knowledge of what someone's benefit would have been under the old plan help them in determining what they need to do to prepare for retirement or is just knowledge of what their benefit will be under the new plan adequate?

RESPONSE

It is clear from the record before the Committee that cash balance proponents consistently have promoted cash balance plans to employers based, at least in part, on the fact that it is difficult if not impossible for employees to compare the benefits they will be receiving under the new cash balance plan to the benefits they would have received under the older traditional plan. Employees adversely impacted by these conversions have been

told for years, and in many instances several decades, what they should expect to receive upon retirement. Because of that background, it is important that the employee be provided meaningful information regarding the impact the announced change will have. Absent the ability of the employee to make a comparison between the terms under which the employee had worked for years and perhaps decades and the circumstances that will prevail the day after the change is implemented, employees are unlikely, as a practical matter, to understand the true financial impact of the change. A side-by-side comparison therefore is critical to permit the employee to make the important decisions that he or she must make to properly plan for retirement.

QUESTION

Less than 10 percent of employees stay with one employer for more than 20 years. Younger employees do not intend to stay at one employer for their entire life and the Society of Actuaries have said that two-thirds of workers fare better under cash balance plans than under traditional defined benefit programs. The Third Millennium, a group representing so-called Generation Xers, has written me saying that cash balance plans reflect the reality of a mobile workforce. Do you believe that the provisions in the Pension Right to Know Act will stop employers from adopting these plans.

RESPONSE

The record before this Committee is clear that certain employers have taken advantage of the lack of any meaningful disclosure requirement in current law to use a conversion to a cash balance or other hybrid plan to "mask" benefit cutbacks in such a fashion that employees do not realize the adverse impact until it is too late. It is certainly possible that certain of those unscrupulous employers might choose not to convert their existing benefit plans if they were required to disclose the adverse impacts of the change to their employees. It seems highly unlikely, however, that more scrupulous companies would forego changes in their pension plans simply because they are required to truthfully disclose the impact of those changes on their employees.

It is important in this context to note that while the promoters of cash balance plans often have argued that the changing trends in job tenure in the United States make cash balance plans more attractive to today's work force than previous generations, those arguments are largely unsupported by the facts. In fact, research suggests that employee job tenure has remained essentially unchanged for many decades. For example, the June 1998 edition of *The Insider*, a newsletter published by Watson Wyatt Worldwide, reported that:

> Contrary to popular belief, Americans are not changing jobs faster than ever before. According to an in-depth study of employment records by Watson Wyatt, as baby boomers are driving up the average age of the workforce, job mobility is decreasing. The study found that average job tenure increased from 12.3 years to 13.1 years since the early 1990s.

Similarly, Eric Lofgren, Global Director of Retirement Practice at Watson Wyatt Worldwide, reported as follows at the 1998 Annual Meeting of the Society of Actuaries:

> "[I]f you look at baby boomers at age 30, they acted just like their parents or grandparents at age 30 in terms of how long they stayed on the job. It is surprising but it is true. At age 40, they've acted like their parents and grandparents in how long they have stayed on the job at age 40 .... So far the boomers have been staying longer, actually, than their parents and their grandparents on the job."

See Plan Design Issues: The Corporate Perspective, 1999 Annual Meeting of the Society of Actuaries (Session PD-98, October 19 - 21, 1998).

Finally, in the preface to this question Chairman Roth makes reference to information that appeared in an article in a publication of the Society of Actuaries. It is important to recognize that the article in question, which appeared in the October 1998 edition of The Pension Forum, was written by Lawrence Sher and Steven Kopp and specifically does not present the views of the Society of Actuaries. In fact, there is an express disavowal on the preface page which indicates that the opinions expressed in the article are "not the opinion or position of the Society of Actuaries, its Sections or Committees, or the employers of the authors." It is equally important to recognize, as the Introduction accompanying the article specifically notes, that the Sher/Kopp article was written "in response to a request from the Cash Balance Practitioners Group," a group of cash balance proponents of which Mr. Sher is a member. Finally, the results reported in the Sher/Kopp article are based upon their application of a number of different actuarial assumptions which have a dramatic impact upon the conclusions reached by the authors, including the one referenced by Chairman Roth.

I raise these issues not to challenge the right of Messrs. Sher and Kopp to vigorously advocate their views favoring cash balance plans or to continue writing such plans on behalf of their clients, but merely to make it very clear that their article is simply one more piece

of the diverse advocacy that has been presented to this Committee on this very important issue. Their article, while perhaps contributing to one side of the debate, is not the type of objective and academic study that this Committee should turn to as a neutral source of information. Rather, it is an advocacy piece that should be analyzed with the scrutiny this Committee gives to any other advocate presenting a position to the Committee.

QUESTION

While we have discussed cash balance plans in this panel, the Pension Right to Know Act requires increased disclosure whenever any type of defined benefit plan decreases future benefit accruals. For example, a plan could be amended to eliminate using bonuses as part of the final play formula. This would trigger disclosure for all participants when they clearly know that their benefit is being reduced. Should there be this expanded disclosure in all instances, or should there be a lesser amount of disclosure required when it is clear to employees that there is a decrease in future benefits?

RESPONSE

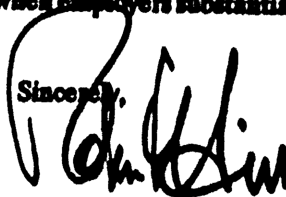
Our entire private pension system is premised upon employees having adequate knowledge to make logical and informed decisions regarding their retirement plans. It is important in this context to recognize the very moderate and limited nature of the Pension Right to Know Act. It does not preclude employers from making changes in their pension plans, even changes that dramatically cut benefits to older, long-term employees. It merely requires the disclosure of those changes in a meaningful fashion and even the disclosure requirement is limited to those circumstances where the reduction is significant.

The record before this Committee clearly establishes the need for legislation requiring meaningful individualized disclosure whenever an employer changes its existing plan to significantly decrease the benefits provided to employees. Regardless of the reason for the reduction in benefits, it is extremely important that employees not only know that a decrease has occurred but also the amount of the decrease so that they can understand the financial impact of that change on them personally. Without that personalized information employees cannot make informed and rational decisions for their retirement. The inevitable consequence of keeping this information from the impacted employees is to increase the likelihood that they will not know the true impact of the change until they retire, and by then it is too late.

Thank you again for giving me this opportunity to respond to Chairman Roth's comments and questions. Please let me know if I can provide any additional information

as the Committee moves forward to finalize legislation addressing the disclosure that appropriately should be provided to employees when employers substantially change pension benefits to the detriment of its employees.

Sincerely,



Robert F. Hill

RFH/pam

STATEMENT BY SENATOR JAMES M. JEFFORDS
HEARING ON PENSION REFORM
JUNE 30, 1999

Mr. Chairman, I commend you for holding these hearings on retirement savings programs and on cash balance plans. Thank you for your leadership in focussing attention on the retirement needs of today's workforce. I look forward to working with you, Mr. Chairman, on improving disclosure for cash balance plans so that employees can better understand what changes in their pension plan will mean for their retirement. It is vital that employees have clear information so they can react to changes in their benefit plan structure -- in order to save more money, if necessary, or change jobs.

It is important to bear in mind that we operate in a voluntary pension system. The tax code and ERISA have been constructed to encourage employers to offer benefits to their employees. We ought to be careful when imposing new requirements on plan sponsors. We don't want encourage large employers to follow the lead of so many small employers who terminated their pensions because the plans became too expensive, complicated and the liability too great to justify maintaining them for *anyone's* benefit.

The Congressional Research Service recently published a report on retirement plans showing that there has been an overall decrease of about nine percent in the number of defined benefit pension plans and a corresponding increase in the number of defined contribution plans, such as 401(k)s.

Defined benefit plans are in some ways better for employees because they provide a stream of benefits over one's entire retirement. Some very large and successful employers, however, have no defined benefit pension plan for their workforce at all. They have made a decision that such a plan is not worth the expense and trouble to maintain. Nor is it worth their while to take on the the liability associated with a defined benefit pension plans generally. But we must not forget that defined benefit plans are an important component of the three-legged stool of retirement security consisting of a defined benefit pension, personal savings and Social Security. We need to take action to improve disclosure for cash balance conversions, but I am convinced that we can achieve that objective without overburdening defined benefit pension plans and their sponsors.

Cash balance plans are a type of hybrid pension. They are called a "hybrid" because they combine some features of traditional pension plans with individual accounts in defined contribution plans. These plans have become controversial when a traditional defined benefit plan is converted to a cash balance plan. This is due to concerns that older workers with many years of service with the employer have been given insufficient information regarding reductions in the rate of increase of their future retirement benefits.

There has been a tendency to make broad, sweeping statements about cash balance plans. Broad generalizations probably misrepresent the facts in most cases. Indeed, cash balance plans are a response to the changing workplace and increasing worker mobility. Median job tenure in the U.S., according the Bureau of Labor Statistics, is 9.4 years for men and is 7.2 years for women. For

people who change jobs often, either in response to layoffs or to compete for better jobs and higher wages, the traditional defined benefit plan is less lucrative than a cash balance pension plan. This is because a cash balance plan allows for steady accruals over employee's the entire tenure with an employer. A traditional pension plan, by contrast, concentrates accruals during the last few years of a long career. Cash balance plans are also more attractive to mobile employees because they allow for portability of benefits when a job change occurs and permit the account to be cashed out and rolled over into an IRA.

On the other hand, workers who spend a long career with a single employer have found that their anticipated benefits, if they worked until normal retirement age, will not increase as rapidly under a cash balance plan as under a traditional pension plan. These individuals probably need better information and options to deal with their changed circumstances. So, the questions we need to be asking are how much information do plan participants want and need; what should be the content of the notice; who should receive the notice and when should they receive it? I think those are the issues upon which we should focus our attention. In this way workers can obtain the information they need to plan and prepare in response to changes in their workplace benefit plans.

TESTIMONY OF
SCOTT J. MACEY
ON BEHALF OF THE ERISA INDUSTRY COMMITTEE
BEFORE THE COMMITTEE ON FINANCE
UNITED STATES SENATE
AT A HEARING ON
PENSION REFORM LEGISLATION
June 30, 1999

My name is Scott J. Macey. I am Senior Counsel, ASA, which until last year was a part of AT&T and for whom we continue to provide benefit advice and administration. I was a senior member of the AT&T law department for 25 years. I also am a member of the Board of Directors and a former Chairman of The ERISA Industry Committee, known as "ERIC," on whose behalf I am appearing today.

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 has played a leadership role in advocating responsible solutions to the critical retirement and health care coverage issue that face our nation. In addition, ERIC recently published policy papers and studies that have received wide acclaim. These include

- *The Vital Connection: An Analysis of the Impact of Social Security Reform on Employer-Sponsored Retirement Plans,*
- *Getting the Job Done: A White Paper on Emerging Pension Issues,* and
- *Policy Statement on Health Care Quality and Consumer Protection.*

ERIC also has proposed numerous amendments to current law designed to facilitate the ability of employers to provide benefits to their employees and to promote national savings. ERIC and its members have worked closely with the Committee on Finance for over twenty-five years to resolve important policy questions and to devise practical solutions to the often vexing problems facing the Committee and the country.

ERIC is gratified that the Committee 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 now before it is too late. The need to do so is reflected in legislation before the Committee, including:

- S.60, The Enhanced Savings Opportunities Act, by Sen. Charles Grassley (R-IA), *et al.*
- S.646, The Retirement Savings Opportunity Act of 1999, by Sens William Roth (R-DE) and Max Baucus (D-Mont.) and
- S.741, The Pension Coverage and Portability Act, by Sens Bob Graham (D-FL) and Charles Grassley (R-IA), *et al.*

S.659, The Pension Right to Know Act, on the other hand, for the reasons explained below and in the attached issue brief [See Attachment A], would have a significant negative impact on defined benefit plans sponsored by major employers such as the members of ERIC. Moreover, the bill makes highly unlikely the creation of new plans and diminishes the prospects that existing plans will continue.

Our testimony today also will comment on the use of excess pension assets to fund other critical employee benefits such as medical benefits for retirees.

Effective Pension Reform

ERIC would like to focus the Committee's attention on S. 646, The Retirement Savings Opportunity Act of 1999, and S. 741, The Pension Coverage and Portability Act, both of which are sponsored and cosponsored by members of this Committee. ERIC thanks the Senators and their staffs who have worked on these bills for the vision, wisdom, and commitment that they have displayed in crafting and introducing legislation that will significantly strengthen the retirement plans that employers voluntarily provide for their employees and improve the ability of workers to provide for their retirement.

At the same time -- and just as importantly -- S. 646 and S. 741 avoid so-called reforms such as those contained in S. 659, which impose overreaching, burdensome, and impractical rules on plans voluntarily sponsored by employers for their employees. In 1987 there were 114,000 defined benefit pension plans insured by the Pension Benefit Guaranty Corporation (PBGC). By 1997 that number had dropped to 45,000, a loss of over 60% over only ten years. Worker demands for individual account savings arrangements can account for some of the shift away from defined benefit plans, but the predominant factor has been the layer upon layer of complex rules imposed on these plans.

The cumulative impact of those rules is so overwhelming that today no plan can be administered in complete compliance with the rules, and the Internal Revenue Service has had to develop an extensive series of compliance programs that allow nonegregious violations to be corrected without penalty.

The impact of this regulatory burden extends beyond enforcement. Because of the many and complex rules that apply, sponsoring a defined benefit plan is significantly more expensive for the employer than sponsoring a defined contribution plan and exposes the employer to significantly greater litigation and potential liability. In addition, the complex rules often make the plans incomprehensible to employer and employee alike. Over the past decade, an increasing number of employers have simply said, "Why bother?" Employers considering establishing retirement plans for their employees over the past ten years in fact have assiduously avoided defined benefit plans.

The decimation of the ranks of defined benefit plans already has significantly reduced the security of workers' retirement savings. It has forced many employees to assume all of the risk of saving for retirement other than what they can expect from Social Security. This is an especially troublesome development for lower income employees, whose ability to save at all is limited and whose ability to invest their savings aggressively in order to maximize the return on their savings is constricted.

Among other important goals, provisions in S. 646 and S. 741 set out a course of action that will encourage and strengthen defined benefit plans and reverse the decline in their sponsorship. S.659 will have precisely the opposite effect and will accelerate the current decline.

ERIC advocates the speedy enactment of major provisions in S. 646 and S. 741 that will (1) increase benefit security and enhance retirement savings, (2) increase pension portability, and (3) rationalize rules affecting plan administration. It urges this Committee to reject S. 659. At the same time, ERIC pledges to work with the Committee to develop legislation to ensure that employees have understandable and useful information about changes to their retirement plans.

Cash Balance Plans

One of the bright lights on the defined benefit plan horizon has been the development of cash balance and other innovative hybrid defined benefit plan designs. These plans respond to employee requests for benefits that are understandable, that are portable, that are compatible with the employee's other savings programs, and that offer significant benefits to women and other employees who typically do not stay with one employer for their entire career. At the same time, these plans preserve the important safeguards of defined benefit plans: the employer typically makes all contributions to the plan and bears the risk of investment, and the employee's benefit is secure and is guaranteed by the PBGC.

Recent news articles and 90-second TV reports regarding cash balance plans have failed to provide useful and balanced information for understanding the dynamics of change in retirement security plans. The stories have failed to show that the new plans provide substantial benefit to millions of workers, failed to show that employers have made a substantial effort to provide reasonable transition rules, and failed to detail how these plans meet the needs of employers and employees in today's changing economy.

We also note tape recorded comments disseminated to this Committee and made by a few persons who are not employers and who do not represent the views or actions of employers. The edited comments suggest that the speakers, who were consultants and/or actuaries, could devise cash balance plans in such a way as to prevent the participants from understanding the impact of a transition from a traditional defined benefit plan to a cash balance plan and to deny participants information that is relevant or material to their benefits and their retirement planning. If these edits accurately portray what the speakers in fact intended, we reject them out of hand. A review of materials actually provided to employees whose employers have converted traditional plans to cash balance plans shows that employers invest enormous resources to ensure that employees understand their benefits and that these efforts are in clear contrast to the edited statements.

If the Congress were to legislate on the basis of these statements, rather than on a careful analysis of what employers in fact are providing to employees, Congress will do egregious harm to millions of employees who benefit from the new plans, to employers who for competitive and other reasons must change the plans they offer, and to the voluntary benefits system as a whole.

S. 659, in this regard, is misdirected and overreaching. Moreover, the bill would impose its draconian solutions on *changes in all types of defined benefit plans*. It is not necessary to go this route. §407 of H.R.1102, by Reps. Rob Portman (R-OH) and Ben Cardin (D-MD) addresses the same issues as S. 659 but does so in a way that ensures that employees have information about changes to their retirement plans in a comprehensible and understandable form that will aid them in planning for their future retirement without imposing undue burdens on plan sponsors.

If, however, Congress believes it needs to enact an amendment that is different from that contained in H.R.1102, ERIC believes that the legislation should adhere to the following principles in order to address Congress's concerns without undermining the voluntary defined benefit system.

1. <u>Notice Only to Participants Reasonably Expected to be Affected</u>: Any mandated notice of a reduction in future benefit accruals should be required to be sent only to persons reasonably expected to be affected by the amendment, not to all participants and alternate payees. Sending mandatory notices to participants who are not affected by plan amendments will not only be superfluous; the notices will needlessly mislead and alarm millions of participants and their families. It is not unusual for a plan amendment to affect only a small number of the employer's employees (e.g. an amendment that affects a specific job category or a single division).

2. <u>Notice Provided Regarding Significant Changes in Plan Design</u>: Any mandated notice requirement should apply only to a significant plan change, not to a change that might reduce the future accrual of isolated individuals. In almost any plan change, it might be possible to construct a hypothetical situation where an individual with an unusual fact pattern might suffer a significant reduction in future benefit accruals. Mandated notice requirements should not be based on the possible existence of hypothetical situations that have little chance of occurrence.

3. <u>Advance Notice</u>: Any advance notification should be required to describe only the principal features of the amendment and their impact on prior plan provisions. The legislation could require the advance notice to describe all significant amendments to the pension plan provisions, including the plan's basic benefit formula, early retirement subsidies, and optional forms of distribution, as well as any wear-away features. Although a notice of this kind might be required as much as 30 days in advance of the effective date of the amendment, an exception should be made for amendments adopted in connection with acquisitions and dispositions, where a 30-day advance notice requirement is often impractical.

4. Hypothetical Examples: Any legislation could require the plan to provide representative hypothetical examples that illustrate the operation of the principal plan features affected by the amendment (such as the plan's basic benefits formula, early retirement subsidies, optional forms of distribution, and any wear-away features). The examples and the assumptions on which the examples are based should not be mandated; the plan administrator should be permitted to select the examples and assumptions that are appropriate for the particular plan and plan amendment. Because the examples and assumptions that are appropriate will vary from case to case, it is not possible for Congress to prescribe uniform examples and assumptions that will be helpful and relevant in all cases.

5. Individual Statement of Account Balance: If the plan states the employee's benefit as an account balance, any legislation could require that, within a reasonable period of time after the effective date, the employee be provided a statement of his or her opening account balance as well as the employee's accrued benefit under the plan prior to the amendment. However, the legislation should not require the employee's accrued benefit to be stated in a form not provided by the plan.

6. No Individualized Projections: Any legislation should not require the plan to prepare individualized projections of participants' benefits – under either the amended plan or the pre-amendment plan. Such projections are unreliable and misleading: they are highly sensitive to future unpredictable events – such as future salary increases, future service, future interest rates, and future plan amendments.

7. Penalty: Any penalty for failing to provide the notice on a timely basis should be limited to an excise tax, similar to the tax imposed by Internal Revenue Code § 4980B for failing to provide a timely COBRA notice. The penalty should not be plan disqualification and/or nullification of the amendment. The consequences of disqualification and nullification are wholly disproportionate to the failure to provide a notice.

8. Uniform Application: Any legislation should apply uniformly to all defined benefit plans. The legislation should not apply solely to large plans, nor should it subject large plans to requirements that differ from those for small plans. There is no legitimate basis for distinguishing between large and small plans in this context. Participants in small plans have the same need for information about their plans as do participants in large plans.

9. No Copy of Amendment: A plan should not be required to provide a copy of the plan amendment automatically to each participant. Plan amendments are often extremely voluminous documents that are of little or no interest or value to virtually all participants. Moreover, participants have the right to inspect or obtain a copy of the plan document under current law. In view of this right, providing participants with a description of the plan amendment fully protects their interests.

AVOIDING MISDIRECTED REGULATORY BURDENS SUCH THOSE IN S. 659

Congress will want to addresses issues that arise as changes in the economy cause changes in retirement plan design. However, ERIC urges that, in addressing these issues, Congress avoid imposing cumbersome burdens and restrictions on employer-sponsored plans that will encourage plan terminations and discourage any employer not already in the pension system from entering. ERIC's concerns with S. 659 are explained in more detail below.

Under ERISA § 204(h), plans must notify participants in advance of any plan amendment that will result in a significant reduction in the rate of benefit accruals under the plan. ERIC's members invest large sums of money and substantial resources in ensuring that employees have a full understanding of their benefit plans and any changes to those plans. ERIC is concerned that modifications currently proposed to legal disclosure requirements will add significantly to plan costs without enhancing employee understanding, impose requirements that are difficult if not impossible to satisfy, and hinder the ability of employers to adjust their plans to meet changing business circumstances or changing employee needs. Any of these results would defeat the purpose of the amendment by making it more difficult for employers to offer significant retirement savings opportunities for their employees.

S. 659 requires employers to distribute information that often will effectively mislead employees. Under the Pension Right to Know Act, whenever a "large" defined benefit plan is amended in a way that results in a significant reduction in the rate of future benefit accrual for *any one* participant, the plan must provide an individually-tailored "statement of benefit change" to *every* plan participant and alternate payee. The "statement of benefit change" must be based on government-mandated assumptions and must project future benefits at several time intervals under both the old and new plan provisions.

The problem is -

- Projections of future benefits are inherently unreliable. Even minor changes between the interest rates required to be used under the bill and rates that in fact occur over time can have a dramatic impact on the value of benefits accrued by individual employees.
- Projections of an employee's possible future benefits required by the government and provided by the employer are easily misinterpreted by the employee as guarantees that benefits will accrue according to the projections provided.
- The benefit statements required by the bill will lead employees to believe that the plan offers a lump-sum option that it might not actually provide.
- The benefit statements required by the bill ignore other changes in the employer's "basket of benefits."
- By requiring projections of future benefit accruals under the old plan's provisions -- which are no longer operative -- the bill falsely implies that participants have the option to retain the old provisions.

S. 659 also imposes burdens on employers that are intolerable and unjustified. For example,

- Under the bill, whenever a defined benefit plan is amended, the employer must analyze the effect of the amendment on *every* individual participant and alternate payee to determine whether the amendment significantly reduces the rate of future benefit accrual for any one of them.
- If the employer finds that the amendment significantly reduces the rate of future benefit accrual for any one participant or alternate payee, the bill requires the employer to prepare an individually-tailored statement of benefit change for every participant and alternate payee.
- Plan amendments frequently affect only a small fraction of the total number of participants (e.g., employees in a specific job category) or affect only active employees. The bill would require notices to be sent to all current and former employees, and retirees regardless of whether they are affected. This will confuse and unnecessarily alarm employees unaffected by the change.
- Existing plans often include numerous features that apply only to certain individuals. Most of the calculations for these employees (which could easily run into the thousands in a large company) will have to be performed by hand. For example, groups of employees often have been grandfathered under prior plan provisions frequently attributable to their participation in a predecessor plan that merged into the existing plan following a merger or acquisition. In addition, many employees also are subject to individual circumstances that will affect their benefits -- e.g. an employee's benefit might be subject to a Qualified Domestic Relations Order (QDRO) or the employee might have had a break in service or a personal or military leave.
- The calculations required by the bill must be completed *before* the changes in the plan become effective. This can take several months. New calculations regarding the employees' actual accrued benefit values must then be calculated *after* the plan becomes effective, since only then will the applicable interest rate and other variables (such as earnings and service) as of the effective date be known. Moreover, this employee information often

must be collected from multiple sources and processed into plan-usable format and plan administrative systems that themselves often require significant reprogramming.

The bill also imposes disproportionate and oppressive tax penalties. At a time when Congress is properly focusing on expanding employer-sponsored retirement plans, the Pension Right to Know Act will have the opposite result. The bill will have a chilling effect on sponsorship of any form of defined benefit plan, pushing medium and large employers to turn to compensation and benefit forms that place employees more at risk for their own economic and retirement security.

INCREASED 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, employer-sponsored 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 B.**] The cumulative impact of constricted limits on employer-sponsored plans has been to reduce significantly retirement savings and imperil the retirement security of many workers.

Provisions in S.646 and S.741 turn this tide at a critical time. If we wait until the baby boom cohort has begun to retire, many employers will not have cash available to pay for rapid increases in pension liabilities, and employees will not have time to accumulate sufficient savings. We must act now.

Just as many of the laws restricting retirement savings were enacted to increase federal revenues, restoring benefit and contribution limits to the more reasonable levels necessary to help employees prepare for retirement will reduce federal revenues over the short term. ERIC recognizes that the Committee has many needs to consider, but ERIC strongly urges the Committee to work with us to ensure that the laws enacted today clearly provide for increased retirement savings opportunities in the future. In reviewing these provisions, Congress should consider the following:

- **Deferred taxes are repaid to the government.** Savings accumulated in tax-qualified retirement plans are not a permanent revenue loss to the federal government. Workers who save now under most types of plans will pay taxes on those savings when they retire in the future. In 1997, tax-qualified employer-sponsored retirement plans paid over $379 billion in benefits, exceeding by almost $63 billion the benefits paid in that year by the Social Security Old Age and Survivors Insurance (OASI) program. In future years, benefits paid from qualified plans will increase dramatically. For example, the 1991 Social Security Advisory Council predicts the percent of elderly receiving a pension will increase from 43 percent in the early 1990s to 76 percent by 2018.

- **Tax-qualified retirement plans help all workers.** Budgetary figures analyzing the distributional impact of estimated tax expenditures for retirement savings in a way that indicates that a "disproportionate" share of the tax expenditure inures to higher-income taxpayers can be extremely misleading in this regard. Such analysis (a) ignores the fact that the top few percent of taxpayers pay most of the income taxes collected, (b) ignores the fact that older workers, who are nearing retirement often have larger accruals than younger workers who are just starting out, (c) is misleading because it obscures the importance of tax deferral in making it economically possible for lower-income workers to save for retirement, and (d) overlooks the fact that the vast majority of participants in employer-sponsored plans are not highly compensated individuals.

  According to calculations by the American Council of Life Insurance based on data contained in the March 1998 Current Population Survey, over 50 percent of the pension benefits paid go to elderly with adjusted gross incomes below $30,000. In addition, among married couples receiving a pension today, 70 percent had incomes below $50,000 and 57 percent had incomes below $40,000. Among widows receiving a pension, nearly 85 percent had incomes below $50,000 and 55 percent had incomes below $25,000. The same ACLI study shows

that over 77 percent of individuals accumulating retirement savings in pension plans in 1997 had earnings below $50,000 and nearly 45 percent had earnings below $30,000.

- **Retirement savings fuel economic growth.** While retirement savings are accumulating in tax-qualified plans, they serve as an engine for economic growth. In 1994, pension funds held 28.2% of our Nation's equity market, 15.6% of its taxable bonds, and 7.4% of its cash securities. In a time of increased concern about national savings rates, retirement plans have been a major source of national savings and capital investment.

- **Today's limits restrict workers' savings.** Many of today's workers' savings and benefits opportunities are significantly restricted by current limits. Recently, in one typical ERIC company, workers who were leaving under an early retirement program and who had career-end earnings of less than $50,000 had the benefits payable to them under their tax-qualified defined benefit plan reduced by the Internal Revenue Code limits. The qualified plan limits also curtail the efforts of women and other individuals who have gaps in their workforce participation or in their pension coverage to make significant savings in a timely manner.

- **Today's limits delay retirement funding.** Limits imposed on defined benefit plans imprudently delay current funding for benefits that workers are accruing today. Funding is restricted because tax-law limits arbitrarily truncate projections of the future salaries on which benefits will be calculated. As a result, in some cases, the employer is still funding an employee's benefits after the employee has retired. This situation will become more burdensome for plan sponsors as the large baby-boom cohort moves to retirement. One of the major purposes of ERISA was to avert precisely this kind of benefit insecurity.

- **Today's limits divide the workforce.** The retirement security of all workers is best served when all workers participate together in a common retirement plan, as was the case until recent years. The current system has created a bifurcated world in which business decision-makers (as well as more and more of those who work for them) depend increasingly on unfunded nonqualified plans for the bulk of their retirement savings.

S. 646 and S. 741 do not fully restore limits to their ERISA levels. They merely begin that process. Restoring limits to more rational levels will be critical to providing retirement security to working Americans in the coming decades. Let me briefly highlight some of the specific provisions that are of particular interest to ERIC members:

S.741(§ 402) restores the limits on early retirement benefits to more appropriate levels. Under ERISA, benefits payable from a tax-qualified plan before age 55 were actuarially reduced. In 1999, the limit at age 55 is more than $20,000 less than the limit set in 1974. The reduction in limits for early retirement -- which already results in reduced benefits for early retirees and disabled workers earning $50,000 and less -- will become even more severe as the Social Security retirement age increases to age 67. S.741 eliminates the requirement for actuarial reductions in benefits that commence between age 62 and the Social Security retirement age and restores the floor for reductions at age 55 or above.

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.

S.741(§ 402) restores the compensation limit to the 1986 level. ERISA had no limit on an employee's compensation that could be taken into account under a tax-qualified retirement plan. The Tax Reform Act of 1986 imposed a limit of $200,000 (indexed) per year. The Omnibus Budget Reconciliation Act of 1993 reduced the limit, and the Retirement Protection Act of 1994 slowed down future indexing. The 1999 compensation limit is $160,000. If the Tax Reform Act limit had remained in effect, the limit today would be $272,520. S.741 would increase the limit to $200,000.

Although this 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 defined benefit 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, projected salary increases today are truncated at the compensation limit, or $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.

S.646 (§ 201) permits employer-sponsored defined contribution plans to allow employees to treat certain elective deferrals as after-tax contributions. In 1997, Congress created a new savings vehicle, commonly known as the Roth IRA. Under this savings option, individuals may make after-tax contributions to a special account. The earnings on those contributions accumulate on a tax-free basis, and no tax is assessed on distributions if certain conditions are met. S.646 permits employers to offer a similar option within the employer's 401(k) plan.

Employer plans offer several advantages to individual savers. Payroll deduction programs make decisions to save less painful and regular savings more likely to occur. Where available, employer matching contributions provide an immediate enhancement of savings. Because plans generally allow each participant to allocate his or her account balance among designated professionally-managed investment funds and index funds, participants enjoy the benefits of professional benefit management. Participants in employer-sponsored plans also are more likely to have free access to information and assistance (e.g., decision guides or benefits forecasting software) that enable them to make better informed investment decisions.

Employees who find the tax treatment of these new accounts attractive will, under the bill's provision, be able to enhance their savings while not losing the benefits of participating in an employer plan.

S. 646 (§204) and S. 741 (§ 201) 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 $30,000 or 25% of the employee's compensation. S. 646 and S. 741 repeal the 25% limit.

The 25% limit does not have a practical impact on a company's upper echelon employees, for whom the dollar limit on annual contributions is lower than 25% of their compensation. Repealing the 25% limit especially assists employees who take advantage of the savings feature in a § 401(k) plan as well as the significant number of women who have reentered the work force after periods of child-rearing and other employees who need to catch up on their retirement savings after periods during which other financial obligations restricted their ability to save.

INCREASED PENSION PORTABILITY

Employers and employees are increasingly involved in mergers, business sales, the creation of joint ventures, and other changes in business structure. (One large pension manager reported that 40% of the new plans that it set up in 1995 resulted from mergers, acquisitions, and divestitures.) Provisions in S. 741 promote pension portability by eliminating a number of significant stumbling blocks to portability created by current law.

S. 741 (§ 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 cannot be included in a rollover to another employer's 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. S. 741 repeals this restriction. We prefer the provision in S.741 over a similar provision in the bill sponsored by Reps. Rob Portman (R-OH) and Ben Cardin (D-MD) that would restrict such rollovers to IRAs. The more narrow provision in H.R.1102 will not allow employees to move their entire account balance to a new employer's plan that accepts rollovers and will not be as effective in preserving retirement savings.

S. 741 (§ 304) 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 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 or her account under the buyer's plan.

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.

§ 401(k) plans are the *only* tax-qualified plans that are subject to the "same desk" rule. [*See* Attachment C] There is no justification for singling out § 401(k) plans for special restrictions on distributions in this way, and ERIC strongly supports repeal of the § 401(k) "same desk" rule, included in S. 741.

S. 741 (§ 305) 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 creates significant administrative impediments for plan sponsors that might otherwise allow their plans to accept direct transfers from other plans.

S. 741 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 certain requirements are met.

S. 741 (§ 603) allows ESOP dividends to be reinvested without the loss of the dividend deduction for the employer. Under current law, an employer may deduct the dividends that it pays on company stock held by an unleveraged employee stock ownership plan ("ESOP") only if the dividends are paid out in cash to plan participants. By favoring early distributions, this rule discourages retirement savings and increases "leakage" from the retirement system, much like the prohibition on including after-tax savings in a rollover (see comments on section 303 of S. 741, above).

Some employers attempt to cope with the restrictions imposed by current law by allowing participants to increase their § 401(k) deferrals by the amount of the dividends distributed to them. However, this arrangement is convoluted, confusing to employees, and effective only up to the legal restrictions on § 401(k) deferrals. S. 741 remedies this unsatisfactory situation by allowing an employer with an ESOP to deduct dividends paid on employer securities held by the ESOP whether paid out in cash or, at the employee's election, left in the plan for reinvestment. This will result in equal treatment of earnings under ESOPs and other defined contribution plans with which they are often associated and further the objective of enhancing both employee ownership and retirement security.

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. Several provisions before the Committee advance the work Congress began in earlier bills to strip away these regulatory "barnacles." For example:

S. 741 (§ 608(a)) provides more flexibility regarding the time when plan administrators must notify employees of their benefit options. IRC § 411(a)(11) provides that a benefit with a present value in excess of $5,000 cannot be distributed in non-annuity form or before the later of age 62 or normal retirement age without first obtaining the participant's consent. IRC section 402(f) requires the plan administrator to provide the recipient of an eligible rollover distribution with a written explanation of certain tax rules within a reasonable period of time prior to making the

distribution. Treasury Regulations require the information to be provided no more than 90 days before the distribution. Frequently, employees will receive the information but will delay receipt of the distribution longer than 90 days. They are confused when the same information is provided again, and the plan incurs unnecessary costs in distributing it. A one-year rule would allow plans to furnish the information in conjunction with other documents that the plan is required to provide on an annual basis.

ERIC urges, however, that §608(b) of S. 741 be deleted from the bill. Contrary to other provisions, this proposal would reaffirm excessive notification requirements that are imposed when an employee takes an in-service distribution from a defined contribution plan.

Other provisions. S. 741 makes other changes that remove regulatory burdens. For example, § 612 would eliminate the requirement to distribute the summary annual report and § 614 would repeal the multiple use test applied to 401(k) plans. ERIC looks forward to working with the Committee on these and other similar provisions.

FLEXIBLE FUNDING FOR EMPLOYEE BENEFITS

Retirement security relies not only on adequate cash resources. For many, the availability of employer-provided retiree medical coverage has materially enhanced their standard of living in retirement. Internal Revenue Code (IRC) § 401(h) allows a pension plan to provide medical benefits to retired employees and their spouses and dependents if the plan meets certain requirements.

These restrictions on 401(h) accounts indicate that only new contributions – not existing plan assets – can be used to fund a 401(h) account. If the plan is very well funded – so that the employer is no longer making any contributions to the plan – 401(h) is not available. Recognizing that this arbitrary restriction unnecessarily imperiled the security of retiree medical benefits, Congress in 1990 enacted IRC § 420 to permit a pension plan to use part of its surplus assets to pay current retiree medical expenses. Although 420 was originally scheduled to expire at the end of 1995, Congress later extended the life of 420 until 2000. In order to make a 420 transfer, the employer must meet a number of requirements.

The Senate Finance Committee recently voted to extend § 420 through September 30, 2009. The Committee also voted to replace the benefit-maintenance requirement with the pre-1994 cost-maintenance requirement. We strongly support the Finance Committee's action.

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

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ATTACHMENT B

A HISTORICAL SUMMARY OF LIMITS IMPOSED ON QUALIFIED PLANS

- **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 1999 is $130,000. If indexing had been left unrestricted since 1974, the limit for 1999 would be approximately $238,000.

- **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).

- **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 1999, the limit (based on a commonly-used plan discount rate) is approximately $52,037. The early retirement reduction will become even greater when the social security retirement age increases to age 66 and age 67.

- **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 1999 limit is still $30,000. If indexing had been left unrestricted since 1974, the 1999 limit would be approximately $79,600.

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 1999 limit is $160,000. If this limit had been indexed since 1986 without reduction the 1999 level would be $272,520.

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 1999 indexed limit is $10,000.

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 C

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[1]

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

THE ERISA INDUSTRY COMMITTEE

I. UNDERSTANDING CASH BALANCE AND OTHER "HYBRID" DEFINED BENEFIT PLAN DESIGNS

The rapid emergence of new, dynamic technologies and obsolescence of many existing products and services, the need to respond to new domestic and global competitors, and the changing attitudes toward career and work by employees in many industries, requires that many employers change their incentives to attract and retain talented employees. For workers and employers in new and changing industries, and for those employees who do not anticipate a single career with one employer but who still value retirement security, the traditional defined benefit plan design has given way to cash balance and similar "hybrid" defined benefit pension plans.

The new plans are responsive to and popular with many employees: the benefits are understandable, secured by the federal Pension Benefit Guaranty Corporation (PBGC), and provide greater benefits to women and others who move in and out of the workforce. Moreover, the employer bears the risk of investment for benefits that are nevertheless portable, and employees under the new plans avoid "pension jail" and "golden handcuffs."

Recent news articles and 90-second "in depth" TV reports have failed to provide useful and balanced background material for understanding the dynamics of change in retirement security plans. Moreover, legislation based on media coverage in an effort to correct reported problems has been misdirected and overreaching.

In order to start fresh and balance the scales, The ERISA Industry Committee has prepared the accompanying materials that identify the issues in the present debate and describe why many employers have shifted from traditional defined benefit plan designs.

The ERISA Industry Committee (ERIC) is a non-profit association committed to the advancement of employee retirement, health, and welfare benefit plans of America's largest employers and is the only organization representing exclusively the employee benefits interests of major 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. The association has a strong interest in proposals affecting its members' ability to deliver those benefits, their cost and their effectiveness, as well as the role of those benefits in the American economy.

We hope that these materials will help in understanding the new direction many employers are taking to provide retirement security. We hope to be in touch with you directly in the coming weeks. In the meantime, please feel free to call on any of us for information or assistance. (Telephone: 202.789.1400. Fax: 202.789.1120). Should you wish to make use of the accompanying materials, they are available on ERIC's Web site at www.eric.org.

Very truly yours,

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May 24, 1999

The ERISA Industry Committee is a non-profit association committed to the advancement of the employee retirement, health care coverage, and welfare benefit plans of America's major employers.

UNDERSTANDING CASH BALANCE PLANS

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ERIC. . LEGISLATIVE BULLETIN

THE ERISA INDUSTRY COMMITTEE

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II. CASH BALANCE DEFINED BENEFIT PLANS

ADJUSTING TO THE REALITIES OF THE MODERN WORKFORCE AND THE MODERN WORKPLACE

The rapid emergence of new technologies and the obsolescence of old products and services are reshaping many industries, forcing companies in those industries to adapt quickly or -- like buggy whip manufacturers in the age of internal combustion engines -- die. Businesses change their ways of doing business, move into new businesses, merge, form joint ventures, acquire other companies or are themselves acquired, and divest old lines of business or are themselves divested as they adjust to challenges and opportunities in today's highly competitive international marketplace.

Many employees in changing industries no longer look forward to a lifetime career with one employer. They expect to change employers more frequently than their parents and grandparents did. "Get a job" has given way to "go hire yourself an employer." For those workers, a retirement plan that requires them to stay with the same company and wait for a big bump-up in the value of their pension benefits in the last few years of employment offers little incentive to join an employer recruiting for top talent.

New plan designs, such as cash balance defined benefit plans, have been embraced by employers and employees alike who need benefit plans that match the new environment in which they work.

WHY CASH BALANCE AND SIMILAR "HYBRID" DB PLAN DESIGNS WORK FOR EMPLOYEES

- BENEFITS ARE UNDERSTANDABLE: Unlike traditional defined benefit plans, cash balance plans provide an easily understood account balance for each participant. Employees - who are accustomed to dealing with bank account balances, § 401(k) account balances, and IRA balances - are comfortable with a retirement plan that provides a benefit in the form of an account balance.

- SAVINGS ACCRUE AUTOMATICALLY: Unlike 401(k) plans, additions are made automatically to the accounts of **all** employees eligible to participate in the plan. The employee does not have to choose to participate or decide how much of his or her current income to defer.

- THE EMPLOYER BEARS THE RISK: Like traditional defined benefit plans, but unlike defined contribution plans (*e.g.* 401(k), money purchase plans, or profit sharing plans), the risk of investment is borne by the plan sponsor. Sudden or even prolonged downturns in the equity or bond investment markets do not affect the defined benefit promised to the participant.

- BENEFITS ARE GUARANTEED: Like traditional defined benefit plans, but unlike defined contribution plans, benefits are insured by the Pension Benefit Guaranty Corporation (PBGC), a government agency.

- GREATER BENEFITS FOR SHORT SERVICE EMPLOYEES: An employee typically earns most of his or her

benefit under a traditional defined benefit plan in the last few years before retirement. By contrast, a cash balance plan delivers benefits more evenly over the employee's career, and an employee who leaves before retirement can roll over the cash balance account to an IRA or a new employer's plan. Thus, cash balance plans are especially attractive in new industries that tend to attract highly talented, mobile workers as well as in industries that are undergoing significant changes.

- WOMEN BENEFIT: Cash balance designs offer significant advantages to women (who are most threatened by impoverishment in old age) and others who tend to move in an out of the workforce. *In fact all mobile workers -- not just women -- are more likely to accrue a significant and secure retirement benefit under cash balance plans than under many other plan designs.*

- OLDER WORKERS BENEFIT: The advantages of a cash balance plan design are not limited to mobile workers, however, since the value of the benefit for an older worker participating in a cash balance plan increases at the same rate both before and after normal retirement age.

- PORTABILITY: Cash balance plan benefits are portable. In addition, when companies are merged, acquired, or form joint ventures, the benefits are easily transferred to a new plan. This helps employees maintain their retirement security.

- EMPLOYEE CONTROL: Since benefits are better understood by employees than are the benefits under many traditional defined benefit plans, employees are more likely to take responsibility for their retirement and their future, resulting in greater personal and national savings.

- GETTING OUT OF "PENSION JAIL:" SLIPPING "GOLDEN HANDCUFFS:" Employees looking to move on to other jobs are less likely to be trapped in jobs that no longer provide challenges or advantages merely because they need to wait for the big bump-up in benefits that occurs in most traditional plans when they fulfill prescribed age and service requirements.

- ANNUITIES ARE AVAILABLE: Since annuities must be offered by a cash balance plan, participants who want to receive their retirement benefit as a stream of income avoid the increased cost and difficulty of purchasing annuities in the individual market. By contrast, if an employee who participates in a defined contribution plan wishes to receive the balance in his or her defined contribution account as an annuity, the employee must approach one or more insurance companies and purchase an annuity on whatever terms are then available to an individual purchaser in the annuity market.

- A "BASKET OF BENEFITS:" A participant's cash balance benefits are easily coordinated with the employer's "basket of benefits" as well as the individual's lifetime retirement savings that includes individual savings and investments, employer provided retirement plans, and Social Security.

EMPLOYERS ALSO SEE PLAN DESIGN ADVANTAGES IN CASH BALANCE AND OTHER HYBRID DEFINED BENEFIT PLANS

- A NEUTRAL IMPACT ON ENTERPRISE DECISIONS: Because cash balance and hybrid plan designs of different companies can be coordinated relatively easily, they offer a stable "platform" to retain employees for companies engaged in mergers and acquisitions.

- APPROPRIATE EMPLOYMENT AND RETIREMENT INCENTIVES: Because cash balance plans deliver benefits

evenly throughout an employee's career, they do not provide undue incentives for employees to "hang on" until reaching retirement age or to retire immediately when they do qualify for retirement.

- BENEFIT COMMUNICATION TO ENCOURAGE SAVING IS ENHANCED: Because benefits in cash balance and hybrid designs are more understandable, retirement benefits and the need to save are easier and more effectively communicated to all employees, including those who ordinarily do not pay much attention to retirement issues.

- EMPLOYEE RECRUITMENT IS ENHANCED: Cash balance and other hybrid plans are an effective tool for attracting new and rewarding current employees.

- BENEFIT COORDINATION IS ENHANCED: Cash balance plans readily are coordinated with the employer's savings or profit-sharing plans.

CASH BALANCE AND OTHER HYBRID DEFINED BENEFIT PLANS BENEFIT THE COUNTRY AS A WHOLE

- CAPITAL ACCUMULATION: Defined benefit plans -- which include cash balance and other hybrid designs -- have for decades been the engine of capital accumulation, making available secure sources of capital for business start-ups and economic expansion that have been responsible for the outstanding success of the American economy.

- MORE EFFICIENT RETIREMENT SAVINGS: Because of the longer investment horizon available under defined benefit plans, the employer can invest the cash balance plan assets more aggressively and can better withstand market downturns while still providing a full benefit than can an individual participating in a defined contribution plan, who must bear investment risks alone.

- INCREASED RETIREMENT SAVINGS: Under cash balance plans, more workers build larger savings earlier in their career, increasing their opportunity to accumulate significant retirement savings.

- INCREASED PENSION PARTICIPATION: All eligible employees automatically accrue benefits under cash balance and other hybrid defined benefit plans. Because benefit accrual is not dependent on an employee's election to participate, more employees whose employers provide a pension plan will actually benefit from the plan.

- GREATER INDEPENDENCE FOR WOMEN: Cash balance plans address the phenomena of the considerable number of elderly poor women with insufficient pension resources and the resulting pressure to increase targeted entitlements.

- MORE COMPATIBLE WORKPLACE FOR WOMEN: The design of cash balance plans can enable an employer to offer a total compensation package that provides more equal value between long service employees and women and others who tend to move in and out of the workforce.

- LESS PRESSURE ON GOVERNMENT PROGRAMS: By providing a reliable source of retirement income, defined benefit plans, including cash balance plans, reduce pressure on government entitlement programs for the elderly.

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III. CASH BALANCE GLOSSARY

Accrued benefit. An accrued benefit is the portion of an employee's normal retirement benefit that he or she has earned at a given point in his or her career.

- Under a cash balance or pension equity plan, the accrued benefit is the employee's account balance. For example, an employee might receive an allocation equal to 4% of pay each year he or she works, and the employee's account might be credited with interest at 5%, compounded annually, until it is paid.

- Under a traditional defined benefit plan, the accrued benefit is the amount the employee would receive as a monthly annuity for life commencing at age 65. For example, if an employee enters a final average pay plan at age 35, works until age 40, and earns average monthly pay of $1,000, that employee's accrued benefit might be $50 (1% x $1,000 x 5 years). If the same employee works until age 55 and his or her average monthly pay increases to $4,000, the accrued benefit would increase to $800 (1% x $4,000 x 20 years).

Actuarially equivalent. Benefits payable at different times or in different forms are actuarially equivalent if they are of equal value, based on certain assumptions. The plan specifies the assumptions that are used to calculate actuarially equivalent benefits. The two assumptions most often used to compare the value of one benefit to another are interest (which is used to measure the value of receiving a payment earlier instead of later) and mortality (which is used to measure the probability that the recipient will live to receive a given payment).

Cash balance plan. A cash balance plan is a defined benefit plan that defines an employee's benefit as the amount credited to an account. The account receives allocations (usually expressed as a percentage of pay) as the employee works. The account is also credited with interest adjustments until it is paid to the employee.

- How is a cash balance plan different from a defined contribution plan? Like other defined benefit plans, a cash balance plan defines an employee's retirement benefit by a formula, and the employee's retirement benefit does not depend either on the employer's contributions to the plan or on the investment performance of the plan's assets, as it would in a defined contribution plan.

- How is a cash balance plan different from other defined benefit plans? A cash balance plan defines an employee's benefit as the amount credited to an account, while other defined benefit plans typically define an employee's benefit as a series of monthly payments.

Defined contribution plan. A defined contribution plan provides contributions to an individual account. The contributions are invested, and the investment gains and losses are also credited to the account. An employee is entitled to receive whatever amount is in his or her account when the employee retires. A section 401(k) plan is a type of defined contribution plan.

Defined benefit plan. A defined benefit plan provides a retirement benefit defined by a formula. An employee's retirement benefit does not depend on the investment performance of the plan's assets.

Early retirement benefit. If an employee retires before normal retirement age (usually 65), most defined benefit plans permit the employee to begin receiving a reduced monthly benefit at an earlier age. The early

retirement benefit must be at least actuarially equivalent to the normal retirement benefit. For example, suppose that an employee has worked until age 55 and earned an accrued benefit of $800, payable as a life annuity commencing at age 65. The plan might permit the employee to retire at 55 and begin receiving an actuarially equivalent early retirement benefit of $360 commencing immediately.

Early retirement subsidy. A benefit includes a subsidy if it is more valuable than the normal retirement benefit. A benefit paid before normal retirement age is said to include an early retirement subsidy if it is greater than the actuarial equivalent of the normal retirement benefit. For example, if an employee has earned a normal retirement benefit of $800 payable as a single life annuity at age 65, an early retirement benefit of $360 at age 55 would be actuarially equivalent to his or her normal retirement benefit; an early retirement benefit of $500 at age 55 would include an early retirement subsidy, and an early retirement benefit of $800 at age 55 would be fully subsidized (that is, it would reflect no actuarial reduction for early payment).

Final average pay plan. Many traditional plans define an employee's benefit as a percentage of average pay at the end of his or her career, when pay is usually highest. For example, an employee's retirement benefit might be 1% of average monthly pay for the last five years of his or her employment, multiplied by his or her credited service. An employee who worked 20 years, and whose final average pay was $4,000 per month, would receive a monthly benefit of $800.

Hybrid plan. A plan that defines an employee's accrued benefit as a single sum is sometimes called a hybrid defined benefit plan, since it combines the appearance of a defined contribution plan with the security of a defined benefit plan. A cash balance plan is one type of hybrid defined benefit plan. Another type of hybrid defined benefit plan is a pension equity plan, which accumulates pension credits and applies them to an employee's pay to calculate a single-sum benefit. For example, a participant in a pension equity plan might earn a credit of 8% for each year of service; after 20 years, he would have a single-sum benefit equal to 160% of his final average pay upon separation from service (regardless of age). There are also defined contribution plans that have the appearance of a defined benefit plan (e.g., a target benefit plan) and that may be called hybrid plans.

- Are hybrid defined benefit plans subject to special legal rules? No. Hybrid defined benefit plans comply with the same legal requirements that apply to other defined benefit plans, including the rules that govern vesting, funding, and payment of benefits.

- Are benefits under a hybrid defined benefit plan available as an annuity? Yes. All hybrid defined benefit plans are required by law to offer annuities. If an employee is married, a hybrid plan automatically pays the employee's retirement benefit as an annuity for the joint lives of the employee and his or her spouse, unless the employee elects another form of payment and the spouse consents.

- Are benefits under a hybrid defined benefit plan federally insured? Yes. Like other defined benefit plans, hybrid defined benefit plans are insured by the Pension Benefit Guaranty Corporation. Hybrid defined benefit plans pay the same premiums to the Pension Benefit Guaranty Corporation that other defined benefit plans pay. This is another feature that distinguishes hybrid defined benefit plans from defined contribution plans (which are not federally insured).

Traditional defined benefit formula. A traditional plan defines an employee's retirement benefit as an annuity beginning at the employee's normal retirement age (usually 65) and paid monthly for his life. Most defined benefit plans provide a benefit based on the service the employee earns as a participant. The benefit payable at the employee's normal retirement age is often called the normal retirement benefit.

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IV. Switching from a Traditional Plan to a Cash Balance Plan – Questions and Answers

Can an employer convert a traditional defined benefit plan to a cash balance plan? Yes. Many employers have converted traditional defined benefit plans to cash balance plans.

Do employees receive notice of the change in their benefits? Yes. If the switch to a cash balance plan reduces the rate at which an employee will earn benefits in the future, the employee receives a notice of the change at least 15 days before it takes effect. All employees receive a "summary of material modifications" describing their new benefits after the benefits have become effective. These are the minimum legal requirements for disclosing the effects of the switch to a cash balance formula. Many employers provide much more information than the law requires about the effect of the switch on individual employees' benefits.

Do employers switch to cash balance plans for cost reasons? Most employers switch because cash balance plans better serve their business needs and their employees' retirement needs. Depending on the plan design, pension costs might fall, rise or stay about the same after a cash balance conversion. If there is a reduction in accounting costs, the reduction often results from accounting rules that tend to "front-load" more of the costs of a traditional defined benefit plan and to spread out more evenly the costs of a cash balance plan. As a result, any short-term cost reduction following the conversion to cash balance is offset by subsequent cost increases.

An employer in financial distress may change its benefit plans to reduce future costs. However, changing to a cash balance plan requires a significant commitment of company resources to ensure that the new plan design is appropriate for the company and the workforce, the transition is implemented smoothly and in accordance with the law, and employees receive appropriate information about the new plan. If an employer's objective is to save costs, it would be far simpler to achieve that goal by merely changing the formula of its traditional defined benefit plan, by terminating the plan, or by switching to a defined contribution plan.

What business or employee needs influence an employer's decision to switch? Under a traditional defined benefit plan, an employee typically earns most of his benefit in the last few years before the employee retires. A cash balance plan delivers benefits more evenly throughout an employee's career, and employees who leaves in mid-career generally can take their benefits with them. Many employers find that the more level, portable benefit provided by a cash balance plan is a better choice for workers who change jobs frequently, for workers who move in and out of the workforce (for example, while they raise families), and for businesses that are bought and sold. Employers also find that employees often appreciate a cash balance benefit more than they do a traditional benefit of equal value, since the cash balance benefit is easier to understand.

When an employer switches to a cash balance plan, what happens to the traditional benefit the employee earned before the conversion? The employer converts the employee's accrued benefit to an opening balance, making specified assumptions about future interest rates, the employee's age at retirement, and other factors. As the employee continues to work after the conversion, the employee earns pay credits and interest credits that are added to the opening balance in the employee's cash balance account.

When an employer switches to a cash balance plan, can an employee's benefit be reduced? No. An employee's benefit is protected by a legal requirement called the "anti-cutback rule." The anti-cutback rule provides that the benefit an employee receives after a plan amendment (such as a cash balance conversion) can never be less than the benefit earned immediately before the amendment. The anti-cutback rule also provides that if an amendment eliminates a benefit subsidy, an employee who qualifies for the subsidy after the amendment will still receive the subsidy on the benefit earned before the amendment

When an employer switches to a cash balance plan, will certain employees earn smaller benefits after the switch? In some cases, yes. A traditional defined benefit plan delivers most of its benefits toward the end of an employee's career. A cash balance plan tends to distribute benefits more evenly throughout an employee's career. As a result, long-service workers might earn less after the switch than they would have earned if the traditional defined benefit plan had stayed in place.

Do employers take steps to prevent the switch from hurting long-service workers? Most employers choose to adopt some form of transition benefit that maintains future benefit levels for long-service workers, at least temporarily. Some employers have allowed employees to choose one time or annually whether they wish to move to the cash balance formula or remain under the traditional formula. Other employers have provided that employees will receive the better of the traditional formula or the cash balance formula for a limited period (e.g., five years) after the switch. Keeping the employee under the traditional formula for a time is sometimes described as "grandfathering" the employee's traditional benefit.

What does "wear away" mean? If an employer switches from a traditional defined benefit plan to a cash balance plan, each employee's accrued benefit is protected by the anti-cutback rule. Under the anti-cutback rule, an employee's lump-sum benefit under the cash balance plan may not be less than the actuarial equivalent of the employee's accrued benefit under the old formula at the time of conversion. Likewise the employee's annuity benefit under the cash balance plan may not be less than the employee's accrued annuity benefit under the old formula at the time of conversion. As the cash balance benefit increases in relation to the old-formula benefits, it is said to "wear away" the benefits calculated under the old formula. However, because interest rates fluctuate, it is not possible to make a reliable prediction of when the cash balance benefit will exceed the benefits under the old formula. When interest rates rise, the present value of the accrued benefit under the old formula might fall below the employee's cash balance account; but if interest rates later decline, the present value of the accrued benefit under the old formula might rise above the cash balance account. Unpredictable interest rate fluctuations thus have a major impact on whether the accrued benefit under the old formula exceeds the cash balance benefit.

What is a "whipsaw"? When the administrator of a traditional defined benefit plan converts a participant's monthly retirement benefit to an actuarially equivalent lump-sum benefit, the administrator must use an interest rate equal to

the 30-year Treasury rate to perform the conversion. Cash balance plans are designed to offer a lump-sum distribution that is equal to the participant's account balance under the plan. The IRS, however, is considering issuing a proposed regulation that might require the administrator of a cash balance plan to perform an annuity-to-lump-sum conversion, even though a cash balance plan defines the benefit as a single sum to begin with. If this approach were adopted, the cash balance administrator might be required to use the plan's interest crediting rate to convert the cash balance account to an annuity, and then use the 30-year Treasury rate to convert the annuity back to a lump sum. If the cash balance interest rate is higher than the 30-year Treasury rate on the date of the conversion, the conversion would produce a lump sum larger than the cash balance account the administrator started with. This effect is sometimes called a **whipsaw**.

How do cash balance plans avoid the risk of being subject to a whipsaw? To avoid the risk of being required to pay a lump-sum benefit that is larger than the cash balance account, cash balance plans often limit their interest credits to a rate that will not exceed the 30-year Treasury rate.

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V. ISSUES RAISED BY THE "PENSION RIGHT TO KNOW ACT" (S.659/H.R.1176)

Under the Pension Right to Know Act, whenever a "large" defined benefit plan is amended in a way that results in a significant reduction in the rate of future benefit accrual for *any one* participant, the plan must provide an individually-tailored "statement of benefit change" to *every* plan participant and alternate payee. The "statement of benefit change" must be based on government-mandated assumptions and must project future benefits at several time intervals under both the old and new plan provisions.

Although promoters of the bill contend that it will improve disclosure to participants, the bill requires the distribution of information that frequently will be misleading. In addition, the bill saddles employers and plan administrators with data collection and reporting obligations that are oppressive and impractical.

The bill requires employers to distribute information that will mislead employees.

❏ *Projections of future benefits are inherently unreliable.*

- Because an individual's benefit under a defined benefit plan depends on such variables as how long he or she will be employed by the employer, future changes in pay, and age at retirement, it is impossible to predict accurately an individual's benefit from a defined benefit plan.

- The present value of the benefit under a traditional defined benefit plan fluctuates dramatically when interest rates change. The bill requires benefit projections to be made on the basis of past interest rate experience that might have little bearing on future interest rates.

- The bill requires each individual's accrued and projected benefits to be calculated before the new plan provisions go into effect. Changes in interest rates and other factors between the time these calculations are made and the time the plan becomes effective can significantly change the value of accrued and projected benefits. When a traditional defined benefit plan is converted to a cash balance plan, this will confuse participants when they are informed of their actual opening account balances under the cash balance plan.

❏ *Projections of an employee's possible future benefits are easily misinterpreted.*

- Because the statements will be issued by employers and required by law, many employees will accept them as reliable indicators of future benefits even if they include

an emphatic disclaimer.

- Employees may base important career and retirement planning decisions on the basis of the misleading statements required by the bill.

- The bill requires projections of benefits under former plan provisions that are no longer in existence, misleading the employee by implying that the former plan provisions are relevant to his or her future retirement planning.

❑ *The benefit statements required by the bill will lead employees to believe that the plan offers a lump-sum option that it might not actually provide.*

- The bill requires a plan to specify the present value of the accrued and projected benefits (i.e., as a lump sum) under both the old and new benefit plan provisions.

- Many defined benefit plans permit distributions only in annuity form (the presumptive form of distribution under ERISA), and do not offer a lump-sum option.

❑ *The benefit statements required by the bill ignore other changes in the employer's "basket of benefits."*

- The bill focuses exclusively on the defined benefit plan that is being amended, and ignores related changes that the employer makes in its compensation and benefits package. For example, an employer that changes its defined benefit plan might simultaneously increase its contributions to its defined contribution plan (for example, by increasing the matching rate under its § 401(k) savings plan).

❑ *By requiring projections of future benefit accruals under the old plan's provisions -- which are no longer operative -- the bill falsely implies that participants have the option to retain the old provisions.*

- When a plan is amended, future benefits under the plan are governed by the new provisions, not the old ones.

The bill imposes oppressive and impractical burdens on employers. The bill imposes obligations on employers that are intolerable and unjustified.

❑ *The bill applies to* <u>*any*</u> *plan amendment that significantly reduces the rate of future benefit accrual* <u>*for even a single participant*</u> *(i.e., it applies whether or not the amendment involves converting a traditional defined benefit plan to a cash balance plan). It requires the mandated calculations to be provided to* <u>*all*</u> *participants and alternative payees.*

- Under the bill, whenever a defined benefit plan is amended, the employer must analyze the effect of the amendment on *every* individual participant and alternative payee to determine whether the amendment significantly reduces the rate of future benefit accrual for any one of them.

- If the employer finds that the amendment significantly reduces the rate of future benefit accrual for any one participant or alternative payee, the bill requires the employer to prepare an individually-tailored statement of benefit change for every participant and alternative payee.

- Existing plans often include numerous features that apply only to certain individuals. For example, groups of employees often have been grandfathered under prior plan provisions frequently attributable to their participation in a predecessor plan that merged into the existing plan following a merger or acquisition. Most of the calculations for these employees (which could easily run into the thousands in a large company) will have to be performed by hand.

- Many employees also are subject to individual circumstances that will affect their benefits - e.g. an employee's benefit might be subject to a Qualified Domestic Relations Order (QDRO) or the employee might have had a break in service or a personal or military leave. The calculations for many of these employees also will have to be performed by hand.

- The calculations required by the bill must be completed *before* the changes in the plan become effective. This can take several months. New calculations regarding the employees' actual accrued benefit values must then be calculated *after* the plan becomes effective, since only then will the applicable interest rate and other variables as of the effective date be known.

❑ *The bill imposes disproportionate and oppressive tax penalties.*

- It will be virtually impossible to perform all the calculations required by the bill accurately. Nevertheless, the bill makes a plan's tax qualification hinge on compliance with its onerous disclosure requirements.

- Plan disqualification means that *employees* will be taxed on their vested benefits (even though their benefits are not yet distributable to them), that the *plan* will be taxed on its investment income, and that the *employer* may not deduct its contributions to the plan.

- This produces huge financial penalties that are likely to be wholly disproportionate to the severity of the violation.

At a time when Congress is properly focusing on expanding employer-sponsored retirement plans, the Pension Right to Know Act will have the opposite result. The bill will have a chilling effect on sponsorship of any form of defined benefit plan, pushing medium and large employers to turn to compensation and benefit forms that place employees more at risk for their own economic and retirement security.

May 24, 1999
PP99CB Briefing

PREPARED STATEMENT OF RITA D. METRAS

Good morning. I am Rita D. Metras, Director - Total Compensation at Eastman Kodak Company. Kodak does business in over 150 countries and provides qualified retirement plans for our employees, who live in nearly every state in the country. I am here today as a representative of the Association of Private Pension and Welfare Plans (APPWP - The Benefits Association). APPWP is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, APPWP's members either sponsor directly or provide services to retirement and health plans covering more than 100 million Americans.

First, I would like to thank you, Mr. Chairman, for holding this hearing on pension reform legislation and for the interest you, Senator Moynihan and the other members of the Committee have shown in discussing the important issues surrounding cash balance plans. On this important topic, I would like to discuss the benefit changes that Kodak has implemented as part of its conversion to a cash balance plan, the factors that have led Kodak and other companies to move toward hybrid plans, and the communications and disclosure that Kodak is providing to employees. I will then offer some comments on S. 659, the Pension Right to Know Act, and on the question of disclosure generally. Finally, I would like to detail APPWP's strong support for two important bipartisan pension reform bills pending before this Committee, the Retirement Savings Opportunity Act (S.646), introduced by Senators Roth and Baucus, and the Pension Coverage and Portability Act (S. 741), introduced by Senators Graham and Grassley together with a bipartisan group of Finance Committee members including Senators Hatch, Jeffords, Chafee, Murkowski, Thompson, Mack, Baucus, Breaux, Kerrey and Robb.

CASH BALANCE ISSUES

Summary of Kodak Changes

Kodak is in the process of changing its retirement program for all new hires from a traditional defined benefit pension plan to a cash balance defined benefit plan plus a 401(k) company match. Because we believe many current employees will also find this new program attractive, anyone who was employed with us prior to March 1, 1999 will be able to choose to remain in the current retirement program or elect the new one. Employees must complete their elections by December 3, 1999. Employees may elect the following:

"Current Retirement Benefits" Choice	"New Retirement Benefits" Choice
• Current traditional defined benefit plan	• Cash balance pension plan with an annual accrual of 4% of pay
• 401(k) with no company match	• 401(k) with 3% company match on salary and bonus
• Company contribution to retiree health care and dental	• No company contribution to retiree health care and dental, but access to programs at company rates
• Company paid life insurance in retirement (1 or 2 times pay, depending on grandfathered status)	• $10,000 company paid life insurance in retirement
• Access to financial planning	• Access to financial planning

If an employee elects the new program, the opening balance in his or her cash balance plan account will be calculated based on the lump sum value of the accrued benefit under the current traditional defined benefit plan. Kodak has no goals or targets for the number of people who will elect the new plan.

Impetus for Change

Remaining Competitive

Kodak, like many other American corporations, changed its retirement program to attract and retain the type of workers it needs to be successful in the future. When potential employees evaluate an offer from Kodak, they often compare us with companies who have a defined contribution plan, such as a 401(k), as their primary retirement vehicle. The change to our new retirement program -- a cash balance plan plus a 401(k) company match -- will make us look more like the companies we compete against for talent. A similar dynamic is playing out in many of the industries where conversions to hybrid plans are occurring. Companies with traditional defined benefit plans are moving to cash balance and other hybrid plans in order to remain competitive with firms that offer the defined contribution or stock purchase arrangements that have proven popular with employees.

Few candidates for employment at Kodak appreciate the value of a defined benefit retirement plan because these plans do not have an individual account that they can see grow and because the candidates do not intend on being long-term employees. They want to know what the company is going to do for them today and they want the portability and flexibility that defined contribution and cash balance plans offer. In a nation where only 9.5 percent of employees work in the same job for 20 years or more,[1] accruing meaningful benefits sooner and more evenly over a career and being able to take retirement savings along to the next job are critically important to workers. Younger employees, high-tech employees, and mid-career employees have all told us that Kodak looks more attractive since we announced the retirement plan change.[2] In some cases, this change has made the difference between someone accepting our offer or choosing to work for another employer.

There were other factors that contributed to our selection of a cash balance plan as part of our new retirement program:

[1] Employee Benefit Research Institute, May 1998 Issue Brief, "Debunking the Retirement Policy Myth: Lifetime Jobs Never Existed for Most Workers."

[2] For many workers in today's mobile economy, cash balance plans will result in greater benefit accumulation than traditional defined benefit plans. In fact, a recent study by the Society of Actuaries found that about two-thirds of employees did better under a cash balance plan than under a traditional defined benefit pension when costs were held constant. The percentage of women faring better under cash balance plans was even higher – about three-quarters – due to their tendency to have shorter job tenure. *See* Steve J. Kopp and Lawrence J. Sher, "A Benefit Value Comparison of a Cash Balance Plan with a Traditional Final Average Pay Defined-Benefit Plan," The Pension Forum, October 1998.

Corporate Restructuring
As companies with traditional defined benefit pension plans restructure by selling businesses or downsizing through layoffs, it can be especially difficult for employees who are short of the "magic date" when benefits under the traditional pension begin to accelerate substantially. There is a lot of anguish expressed, such as "if I could have only stayed 1 month, 6 months, 3 years, etc. longer, I would have gotten a lot more retirement benefit." A cash balance plan addresses this problem since employees have steadily increasing account balances and there is no need to work to a specific date before getting a significant portion of the retirement benefit.

Retaining Skilled Workers
On the other hand, employees who remain with the company after they have reached 100% eligibility for retirement benefits under a traditional defined benefit pension believe they are working "for nothing" and often look to leave. A cash balance plan eliminates this concern since employees earn a significant benefit for each year of additional employment regardless of their length of service with the company. This allows Kodak and other companies to retain successful workers who might have had an incentive to leave earlier under our prior retirement program. Under a cash balance plan, retirement benefits are no longer incenting employees to stay <u>or</u> leave; rather, employment decisions are being made based on the employee's satisfaction with the work environment and the employer's satisfaction with work performance.

Ease of Communication
Cash balance plans tend to be much easier to understand and communicate than traditional defined benefit plans. We find that, unless employees are close to retirement, there is little understanding and almost no appreciation for the traditional retirement plan. Vested employees who request an estimate of their benefit under the traditional plan are often surprised at how small the benefit is even after 15 or 20 years of service. In contrast, cash balance plans provide sizable benefits early in a career and, because of their account design, provide employees with a very clear sense of how much they have earned in benefits. The greater understanding that comes with cash balance plans means employees are better equipped to undertake retirement planning and determine what level of 401(k) contributions and/or other personal savings may be needed to supplement their underlying pension benefit.

Cost
Kodak developed its new retirement program so that it would be cost neutral -- that is, no significant costs or savings to the company would result from switching from the traditional pension to the cash balance plan plus the 401(k) match. There are certainly other situations where a conversion to a cash balance plan results in cost savings for a company and these situations have received significant media attention. We fear that this media attention has the potential to blur the issue at hand. The issue is not whether a company saves money -- as we all know, companies have a legal obligation to their shareholders to monitor and evaluate all expenses, and to modify them as appropriate -- the issue is whether the company has appropriately disclosed the effect of its actions to its employees.

We would nevertheless like to point out certain items related to cost savings. In many instances, such as ours, a conversion to a cash balance plan is part of a broader restructuring of employee benefits. Defined benefit plan savings may well be offset, in part or in whole, by increases in other benefits and compensation, such as increasing the 401(k) plan match or implementing or expanding stock options. And in many instances (again such as ours), the conversion is cost neutral or sometimes even more costly in the short term due to transition benefits (see below). The reasons a company undertakes such a large project in the absence of cost savings are those set forth above: remaining competitive, facilitating corporate restructuring, retaining skilled workers, and improving benefit communications.

Defined Benefit Plan Advantages

We believe that our cash balance design combined with a 401(k) match offers employees what they are looking for while providing a significant level of retirement income protection for employees. With a cash balance design -- as with other defined benefit plans -- employers are responsible for funding the plan and bearing the investment risk and employees enjoy the advantages of pension insurance and benefits offered in the form of joint and survivor annuities. Kodak and the other companies that have converted to cash balance plans remain committed to the defined benefit system and the advantages it offers to participants.

Transition Benefits

For companies that do not take the unusual step, as we did, of offering current employees a choice between the current and new plans, considerable time and energy is spent designing transition provisions to assist workers nearing retirement age who may not accrue as much in benefits going forward as they would have under the prior plan. The transition benefits employers provide vary, but can include "grandfathering" some or all employees in the prior pension plan either until retirement or for a period of years;[3] providing some or all workers with additional amounts in their opening cash balance accounts; and providing some workers with additional pay or interest credits in the cash balance plan for a period of years or until retirement. The provision of these transition benefits belies the notion that companies engage in conversions in a cavalier manner, disregarding the concerns and interests of their older and longer-service employees.

Kodak's Education about the Choice of Plans

Because Kodak offered current employees a choice between the current and new retirement programs, extensive education about the options was necessary and appropriate due to both fiduciary issues and employee relations concerns. Kodak provided the following:

- A detailed decision guide that compared the plans;
- A comparison of projected benefits under the current and new plans based on interest rates in effect when the comparisons were prepared;
- Employee meetings led by financial experts;

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[3] Under the range of grandfathering arrangements, employees over *X* age and/or *Y* years of service may stay in the old plan for some period of additional years or until retirement or may receive at retirement whichever benefit level is higher -- that which would have been earned under the prior traditional plan or that earned under the new cash balance plan.

- Telephone help-line staffed by financial experts;
- Modeling software to allow employees to run comparisons using alternative assumptions for factors such as interest rates, projected salary increases, and compensation;
- Intranet web sites with articles and answers to frequently asked questions; and
- Numerous newsletter articles.

Obviously, the commitment both in people resources and in dollars to provide these materials and services was tremendous. We believe that this commitment of personnel and time was appropriate because we were asking our employees to make a very important choice between complicated benefit arrangements. On the other hand, we believe that there are many situations where this enormous burden is not justified, such as situations where employees have little or no choice.

Disclosure

This question of what type of disclosure is appropriate when companies convert to cash balance and other hybrid plans is one that requires careful thought. We must look beyond the current media hype and the case of any one individual or company to make the appropriate policy judgment about what is best for pension participants generally and our pension system as a whole. With our defined benefit pension system already in decline and policymakers appropriately focused on how to revitalize it,[4] Congress should proceed very cautiously in adding to the already substantial burdens of administering a cash balance or other defined benefit plan.

Because Kodak offered choice to employees and so provided very extensive disclosure about the new retirement plan and its impact on employees, we are uniquely positioned to comment on the disclosure issue. Almost everyone, including Kodak, agrees that employees should receive notice that the pension plan has changed and what the new provisions are. Yet the legislation that has been introduced to address the disclosure issue, specifically S. 659, the Pension Right to Know Act, requires vastly more than this, mandating detailed calculations for every individual employee comparing benefits under the former and new plans at many different points in time. The process of preparing these statements would require the employer to gather and verify substantial information on potentially tens of thousands of individual workers. This burden would be made even more substantial by the apparent requirement in S. 659 that the individualized calculations and projections be provided not only to the employees facing a benefit reduction but to all employees.[5]

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[4] The Pension Benefit Guaranty Corporation reports that since 1985 the number of defined benefit plans it insures has dropped from 114,000 to 45,000. The number of active workers in all defined benefit plans has dropped from 29 million in 1985 to fewer than 25 million in 1994. Pension Benefit Guaranty Corporation 1998 Annual Report, p. 6.

[5] It bears noting that even the extensive communication and disclosure we provided at Kodak would still not have met the requirements of S. 659 in several areas.

In light of the vast amount of time and resources required to prepare the personalized statements mandated under S. 659, it is critical to assess the value of individualized disclosure. I would like to make two points in this regard. First, specific individualized benefit projections can be very misleading due to the dramatic effect of even a small change in the assumptions, such as the applicable interest rate. Second, it is clear that in many cases, more voluminous disclosure does not translate into more meaningful disclosure. Pension regulators and benefits professionals alike have come to realize that the degree to which pension plan notices are read and used by workers is often directly related to the brevity and simplicity of these notices. Detailed and elaborate individualized statements will be read far less often than more simply stated descriptive language.

It is also critical to recognize that while much of the current debate about disclosure has been focused on cash balance plans, S. 659's requirement for personalized benefit calculations and projections would apply not only to cash balance conversions but also to a much broader range of less complex defined benefit plan changes. We are very concerned that the broad application of the bill has not received the serious attention it merits. An employer that amends a traditional defined benefit plan to reduce future accruals, such as by lowering the rate of accrual from 1.5% per year to 1.25% per year, would be required by S. 659 to produce voluminous data on individual employees. This voluminous data is completely unnecessary since a simple statement of the amendment would make its effect clear to all employees. Moreover, employers not undergoing a conversion to a different type of plan would not typically be engaged in gathering employee information and so would have to manually assemble much of the detailed compensation and service data required by S. 659. In short, outside the context of a conversion from a traditional defined benefit plan to a hybrid defined benefit plan (or a similarly fundamental structural change), the personnel resources needed to gather data and comply with the detailed disclosure requirement of S. 659 could be even higher, and the value of such detailed disclosure is minimal. This is yet another reason that S. 659 should be opposed.

We at APPWP are also concerned about the draconian penalty that S. 659 would impose on companies that make an error in complying with the bill's complex individualized disclosure regime. Not only would the amendment changing the pension plan be rendered ineffective under S. 659, but the plan would also lose its tax qualified status. This is the most severe sanction that can be imposed on a retirement plan and results in direct harm not only to the plan but also to employees who lose the tax benefit associated with their retirement savings.

Even were all of the concerns I have discussed above addressed, a basic issue remains – should companies be forced to provide individualized information on a benefit plan that no longer exists? Instead of focusing on the past, the emphasis of any disclosure should be on the new plan and the part it plays in an employee's financial security in retirement. This could be accomplished by outlining the nature of the plan change in descriptive terms and perhaps by providing a small number of representative examples of how the new provisions will affect employees.

It is critical that companies maintain the ability to make business decisions about the benefit plans they offer without the additional, onerous legal requirements and fear of draconian penalties that S. 659 would impose. If companies feel they cannot maintain this needed flexibility within the defined benefit system, they will abandon these plans at an even more rapid rate. This would be a clear step backward for our nation's retirement policy.

BIPARTISAN PENSION REFORM

Let me turn now to a discussion of legislation pending before this Committee that APPWP believes will strengthen our employer-sponsored retirement system and offer American families new assistance in saving for retirement.

Retirement Savings Opportunity Act
The first bill I would like to mention, Mr. Chairman, is your own S. 646, the Retirement Savings Opportunity Act, which you have introduced with Senator Baucus. We at APPWP would like to thank you for once again demonstrating uniquc leadership on the issue of retirement savings. We are particularly grateful that your legislation includes provisions specifically designed to strengthen the employer-sponsored pension system.

Restoration of Limits
In addition to the bill's many important Individual Retirement Account measures, one of the most significant reforms contained in S. 646 is the restoration to previous dollar levels of several contribution limits that cap the amount that can be saved in workplace retirement plans. These caps have been reduced repeatedly for budgetary reasons and are lower today in actual dollar terms -- to say nothing of the effect of inflation -- than they were many years ago.

APPWP believes strongly that restoring these limits will result in more employers offering retirement plans. Restored limits will convince business owners that they will be able to fund a reasonable retirement benefit for themselves and other key employees, will encourage these individuals to establish and improve qualified retirement plans, and will thereby result in retirement benefits for more rank-and-file workers. And as you have articulated so clearly, Mr. Chairman, restored limits are also critical for the many baby boomers who must increase their savings in the years ahead in order to build adequate retirement income.

The catch-up contribution contained in S. 646 -- which would permit those employees who have reached age 50 to contribute an additional 50% of the annual limit each year to a defined contribution plan or IRA -- will likewise address the savings needs of baby boomers and will provide an especially important savings tool for the many women who return to the workforce after raising children. S. 646 would also remedy a current restriction on savers of modest income levels. Annual contributions to defined contribution plans such as 401(k)s are limited to the lesser of $30,000 or 25% of compensation. Unfortunately, the percentage of compensation restriction actually limits the retirement savings of modest-income workers while having no effect on the highly-paid. Removing this percentage cap on compensation would eliminate a barrier that blocks the path of many modest-income savers.

Defined Benefit Plan Funding

APPWP is also pleased that S. 646 includes an important pension funding reform that we have long advocated. The bill's repeal of the 150% of current liability funding limit for defined benefit plans would remove a budget-driven constraint in our pension law that has prevented companies from funding the benefits they have promised to their workers. This funding limit forces systematic underfunding of plans, as well as erratic and unstable contribution patterns. In effect, current law requires plans to be funded with payments that escalate in later years. Thus, employers whose contributions are now limited will have to contribute more in future years to meet the benefit obligations of tomorrow's retirees. If changes to this funding limit are not made now, some employers may be in the position of being unable to make up this shortfall and forced to curtail benefits or terminate plans.

Pension Coverage and Portability Act

Many of these same important limit and funding reforms are contained in another leading bipartisan pension bill introduced by two distinguished Finance Committee members, Senators Bob Graham and Charles Grassley. The Pension Coverage and Portability Act, S. 741, continues the long dedication of these two Senators to the issue of pension reform and enhanced retirement security for American families. Once again, Senators Graham and Grassley have worked with a large bipartisan team of Finance Committee members, including Senators Hatch, Jeffords, Baucus and Breaux, to introduce a responsible and technically sound bill that sets a comprehensive course for improvement of our nation's employer-sponsored retirement system.

In addition to the important measures in S. 741 that restore benefit and contribution limits and improve pension plan funding, the legislation also contains reforms in three additional areas – simplified pension regulation, new retirement savings tools and enhanced pension portability – that APPWP believes are key to the health and strength of our nation's private pension system.

Simplification of Pension Regulation

The simplification measures in S. 741 will help remedy the astounding complexity of pension regulation, which today drives businesspeople out of the retirement system and deters many from even initiating a retirement plan at all. Not only are businesspeople leery of the cost of complying with such regulation, but many fear that they simply will be unable to comply with rules they cannot understand. We must cut through this complexity if we are to keep those employers with existing plans in the system and prompt additional businesses to enter the system for the first time.

A more workable structure of pension regulation can be achieved only by adhering to a policy that encourages the maximization of fair, secure, and adequate retirement benefits in the retirement system as a whole, rather than focusing solely on ways to inhibit rare (and often theoretical) abuses. This can be accomplished by ensuring that all pension legislation is consistent with continued movement toward a simpler regulatory framework. In short, simplification must be an ongoing process. Proposals that add complexity and administrative cost, no matter how well-intentioned, must be resisted, and the steps taken in earlier pension

simplification legislation must be continued. Current rules must be continuously reexamined to weed out those that are obsolete and unnecessary.

Mr. Chairman, S. 741 contains a broad array of simplification provisions to address regulatory complexity. Let me briefly mention a few that APPWP believes would provide particular relief for plan sponsors. First, the legislation would provide flexibility with regard to the coverage and non-discrimination tests in current law, allowing employers to demonstrate proper plan coverage and benefits either through the existing mechanical tests or through facts and circumstances tests. Second, the bill would repeal the duplicative multiple use test, which will eliminate a needless complication for employers of all sizes. Third, the bill would simplify and streamline the top-heavy rules, which are a source of much unnecessary complexity for small employers. And fourth, the bill would promote sounder plan funding and predictable plan budgeting through earlier valuation of defined benefit plan funding figures.

APPWP believes that the cumulative effect of the regulatory reforms in S. 741 will be truly significant. Reducing the stranglehold that regulatory complexity holds over today's pension system will be a key factor in improving the system's health and encouraging new coverage over the long-term. As pension legislation progresses through this Committee and the Congress, Mr. Chairman, we would urge you to keep these simplification measures at the very top of your pension reform agenda.

New Retirement Savings Tools

S. 741 also contains several important proposals that offer new help to American families saving for retirement.

- **ESOP Dividend Deduction.** First, the bill includes an important change in the tax treatment of ESOP dividends that would provide employees with a greater opportunity for enhanced retirement savings and stock ownership. Under current law, deductions are allowed on dividends paid on employer stock in an unleveraged ESOP only if the dividends are paid to employees in cash; the deduction is denied if the dividends remain in the ESOP for reinvestment. Under S. 741, deductions would also be allowed when employees choose to leave the dividends in the plan for reinvestment, encouraging the accumulation of retirement savings through the employee's ownership interest in the employer. This important change is also contained in a stand-alone bill, S. 1132, which has been introduced by Senators Breaux, Hatch and Robb.

- **Automatic Plan Enrollment.** Second, S. 741 creates a new designed-based safe harbor -- the Negative Election Trust (NET) -- which encourages employers to enroll new workers automatically in savings plans when they begin employment. Automatic enrollment arrangements such as the NET have been shown to boost plan participation rates substantially, particularly among modest-income workers.

- **Retirement Education.** Third, the legislation would remedy the uncertainty and complexity that today surrounds the tax treatment of employer-provided retirement counseling. All employer-provided retirement planning, including planning that does not relate to the employer's plans, would be excludable from employee's income under S. 741. The bill would also make clear that employees could purchase retirement counseling through salary reduction on a pre-tax basis. Since many employers provide retirement education to their employees or would like to do so, it is critical that the law surrounding the tax treatment of this benefit be clear. Moreover, given the importance and popularity of 401(k) plans, where the primary responsibility for saving and investing falls on employees, employers should continue to be encouraged to provide information and education about these plans.

Enhanced Pension Portability

Another important advance in S. 741 is the cluster of provisions designed to enhance pension portability. Not only will these initiatives make it easier for individual workers to take their defined contribution savings with them when they move from job to job, but they will also reduce leakage out of the retirement system by facilitating rollovers where today they are not permitted.

The bill's portability initiatives will also help eliminate several rigid regulatory barriers that have acted as impediments to portability. Repeal of the "same desk" rule will allow workers who continue to work in the same job after their company has been acquired to move their 401(k) account balance to their new employer's plan. Reform of the "anti-cutback" rule will make it easier for defined benefit and other plans to be combined and streamlined in the wake of corporate combinations and will eliminate a substantial source of confusion for plan participants.

Conclusion

Mr. Chairman, Senator Moynihan, thank you for the opportunity to appear before you this morning. Kodak and APPWP would be pleased to work with you on any of the important pension issues we have discussed today.

APPWP The Benefits Association

NEWS

June 30, 1999
PR-99/22

For additional information:
Deanna Johnson Keim, 202-289-6700

Private Pension and Welfare Plans

Advance Retirement Security This Year

APPWP Urges Senate Finance Panel to Include Roth-Baucus, Graham-Grassley Bills in Upcoming Tax Legislation

WASHINGTON, DC — The Association of Private Pension and Welfare Plans (APPWP — The Benefits Association) today urged members of the Senate Finance Committee to include the bipartisan pension reform measures introduced by Committee Chairman William Roth (R-DE) and Senator Max Baucus (D-MT) and by panel members Bob Graham (D-FL) and Charles Grassley (R-IA) in upcoming tax legislation. Speaking on behalf of APPWP during the full panel's hearing, Rita D. Metras, Director — Total Compensation at Eastman Kodak Company, said the provisions in both bills — many of which were originally proposed by APPWP — will expand the employer-sponsored retirement system and offer new help to American families saving for retirement.

Metras stated, "APPWP heartily supports these two important pension reform bills and strongly advocates their inclusion as part of the tax bill the Committee will soon prepare. With passage of Roth-Baucus and Graham-Grassley, this Committee and this Congress can advance retirement security at a time when this issue is of increasing concern to American families. Even if Social Security reform is not achieved this year, Congress can and should move in a bipartisan fashion to strengthen our nation's private pension system."

While the bills contain many similar provisions, Metras highlighted two areas of note in Senators Roth and Baucus' Retirement Savings Opportunity Act (S. 646):

Restoration of Limits

"APPWP believes strongly that the restoration to previous dollar levels of several contribution limits that cap the amount that can be saved in workplace retirement plans will result in more employers offering retirement plans. Restored limits will convince business owners that they will be able to fund a reasonable retirement benefit for themselves and other key employees, will encourage these individuals to establish and improve qualified retirement plans, and will thereby result in retirement benefits for more rank-and-file workers. Also, the catch-up contribution — which would permit those employees who have reached age 50 to contribute an additional 50 percent of the annual limit each year to a defined contribution plan or IRA — will address the savings needs of baby boomers and provide an especially important savings tool for the many women who return to the workforce after raising children."

— more —

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APPWP Urges Senate Finance Panel to Add Roth-Baucus, Graham-Grassley to Tax Bill
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Defined Benefit Plan Funding
"S. 646's repeal of the 150 percent of current liability funding limit for defined benefit plans would remove a budget-driven constraint in our pension law that forces systematic underfunding of plans, as well as erratic and unstable contribution patterns."

Then citing Senators Graham and Grassley's Pension Coverage and Portability Act (S. 741), Metras outlined three additional issues as being key to the health and strength of America's private pension system:

Simplification of Pension Regulation
"The simplification measures in S. 741 will help remedy the astounding complexity of pension regulation, which today drives businesspeople out of the retirement system and deters many from even initiating a retirement plan at all. Not only are businesspeople leery of the cost of complying with such regulation, but many fear that they simply will be unable to comply with rules they cannot understand. Of significance, this legislation would provide flexibility with regard to the coverage and nondiscrimination tests in current law, repeal the duplicative multiple use test, simplify and streamline the top-heavy rules, and promote sounder plan funding and predictable plan budgeting through earlier valuation of defined benefit plan funding figures."

New Retirement Savings Tools
"S. 741 also contains several important proposals that offer new help to American families saving for retirement including: (1) an important change in the tax treatment of ESOP plans allowing dividends to be reinvested for retirement; (2) creation of a new designed-based 401(k) safe harbor — the Negative Election Trust (NET) — which encourages employers to enroll new workers automatically in savings plans when they begin employment; and (3) an exclusion from employee income of all employer-provided retirement counseling."

Enhanced Pension Portability
"The cluster of provisions in this bill designed to enhance pension portability will not only make it easier for individual workers to take their defined contribution savings with them when they move from job to job, but will also reduce leakage out of the retirement system by facilitating rollovers where today they are not permitted. The bill will also help eliminate several rigid regulatory barriers — the 'same desk' and 'anti-cutback' rules — that have acted as impediments to portability."

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Full copies of Rita D. Metras' testimony are available on APPWP's web site at www.appwp.org, or by contacting Jenny Schroen at 202-289-6700 or by e-mail at jschroen@appwp.org.

The Association of Private Pension and Welfare Plans (APPWP — The Benefits Association) is the national trade association for companies concerned about federal legislation and regulations affecting all aspects of the employee benefits system. APPWP's members represent the entire spectrum of the private employee benefits community and either sponsor directly or administer retirement and health plans covering more than 100 million Americans.

APPWP The Benefits Association

NEWS

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For additional information:
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Association of Private Pension and Welfare Plans

Cash Balance Plan Disclosure Legislation

APPWP Urges Senate Finance Panel Not to Burden Defined Benefit Pension System

WASHINGTON, DC — The Association of Private Pension and Welfare Plans (APPWP — The Benefits Association) today urged members of the Senate Finance Committee not to burden the already declining defined benefit pension system with an overwhelming set of disclosure requirements. Speaking on behalf of APPWP during the full panel's hearing, Rita D. Metras, Director — Total Compensation at Eastman Kodak Company, explained employer interest in cash balance pension plans and outlined concerns with the Pension Right to Know Act (S. 659) disclosure legislation introduced by Committee Ranking Member Daniel Patrick Moynihan (D-NY).

Recent controversial media coverage has followed the increasing number of employers moving to these hybrid defined benefit retirement plans, but reports have failed to accurately explain employer motives or the benefits for employees. Said Metras, "Like many other American corporations, Kodak changed its retirement program to attract and retain the type of workers it needs to be successful. Unfortunately, few candidates for employment appreciate the value of a traditional defined benefit plan and many favor the 401(k) and stock plans offered by our competitors. With their account design, cash balance plans are much easier to understand and communicate than traditional plans and employees like their portability and steady accrual pattern. Already, the change to cash balance has made the difference between candidates accepting our offers of employment or working elsewhere."

Metras noted that many companies "grandfather" employees near retirement in the current plan and/or provide additional transition benefits for employees who have significant service. "These actions belie the notion that companies engage in conversions in a cavalier manner, disregarding the interests of their long-service workers," she added.

Metras said that passage of S. 659 would "impose new burdens on the defined benefit system, mandating detailed calculations for every employee — even those not facing a reduction — comparing benefits under the former and new plans at many different points in time. Meeting this mandate would require employers to gather and verify information on potentially tens of thousands of employees. Individualized benefit projections can also prove misleading as modest changes in assumptions often produce dramatically different results. Furthermore, voluminous disclosure is not necessarily

— more —

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meaningful disclosure. The degree to which pension notices are read and used by workers is often directly related to the brevity and simplicity of these notices."

Metras said, "We are also concerned that S. 659's requirement for individualized projections applies to a very broad range of defined benefit plan changes beyond plan conversions and that this broad application has not received the serious attention it merits. The burdens would be great in many of these situations while the value of individualized information is often limited. The bill's penalty of plan disqualification is also disproportionate and unduly severe."

"Because Kodak offered current employees a choice, extensive education and comparisons were necessary," she added. "Yet even with all the disclosure we provided, we would not have met the requirements of S. 659."

Metras concluded by stating APPWP's support for more workable enhancements to current disclosure rules. "We at APPWP share the goal of seeing that workers are provided with useful information about how their retirement benefits are affected by the change to a cash balance plan. We are committed to working with the members of this Committee to craft a practical solution that does not create an undue burden for our defined benefit system."

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Full copies of Rita D. Metras' testimony are available on APPWP's web site at www.appwp.org, or by contacting Jenny Schroen at 202-289-6700 or by e-mail at jschroen@appwp.org.

The Association of Private Pension and Welfare Plans (APPWP — The Benefits Association) is the national trade association for companies concerned about federal legislation and regulations affecting all aspects of the employee benefits system. APPWP's members represent the entire spectrum of the private employee benefits community and either sponsor directly or administer retirement and health plans covering more than 100 million Americans.

APPWP The Benefits Association

LEGISLATIVE ACTION

April 23, 1999
LA-99/2

An information report for members of Congress and their staff

Addressing Today's Workforce Needs

APPWP Voices Cash Balance Plans' Benefits to Employees and Employers

Both the media and policymakers on Capitol Hill have recently devoted considerable attention to "cash balance" pension plans, a pension design being adopted by a growing number of American companies. Much of the attention centers on the issues that arise when a business converts its retirement plan from a traditional defined benefit pension plan to a cash balance form of defined benefit plan. This APPWP Legislative Action (1) describes how cash balance plans operate, (2) discusses the reasons why these plans are suited to today's workforce and have been attractive to employers and employees, (3) outlines the process of converting to a cash balance plan, (4) addresses the disclosure issues cash balance conversions can raise, and (5) places these conversions in the context of our nation's voluntary pension system.

THE BASICS OF CASH BALANCE PLANS

Formally a defined benefit plan, a cash balance plan is known as a "hybrid" pension plan. The cash balance design combines features of a traditional defined benefit pension with those of a defined contribution plan such as a 401(k). In a traditional defined benefit plan, an individual's pension is generally determined by a formula incorporating the employee's years of service and pay near retirement. The benefit in this traditional pension is expressed in the form of a lifetime annuity (stream of income) beginning at normal retirement age, which is typically 65. In a cash balance plan, an individual's pension is generally determined by an annual benefit credit (typically a percentage of pay) and an annual interest credit (an annual rate of interest that is specified by the plan). These benefit and interest credits are expressed as additions to an individual's cash balance account. These accounts grow over time as the benefit and interest credits accumulate. Benefits in a cash balance plan are ultimately paid out in the form of a lifetime annuity or a lump sum.

While a cash balance plan's operations may seem similar to those of a 401(k), there are numerous differences including three that are critical from a policy perspective. First, the investment decisions — and risks — in cash balance plans are generally the responsibility of

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the employer, not the individual employee. Even though the benefits are expressed in the form of individual accounts, a cash balance plan's assets are managed in the aggregate by the plan trustee. Second, cash balance plans are covered by the Pension Benefit Guaranty Corporation's insurance program, meaning participants' benefits are protected even if the plan or the company runs into financial difficulty. Third, cash balance plans must offer employees the ability, within the plan, to convert their account balances to lifetime annuities at no additional cost. These advantages of reduced employee risk, pension insurance and lifetime payments can be married in cash balance plans with popular individual account and enhanced portability features.

CASH BALANCE PLANS MEET CURRENT BUSINESS AND WORKFORCE NEEDS

Why are cash balance plans attractive to employers? While cost has been a consideration for some (see below), many move to cash balance plans because these plans are more responsive to today's workforce. Traditional defined benefit pensions — where much of the value of the benefit is earned in the final years before retirement — are effective for employees who spend a complete career with a single employer. These plans, however, can produce disappointing results for employees who switch jobs several times during their careers, which most Americans do. According to the Employee Benefit Research Institute, only 9.5 percent of employees work in the same job for 20 years or more. Cash balance plans were developed to respond to the reality of today's mobile workforce. For mobile workers, cash balance plans provide meaningful benefits sooner and more evenly over a career so that shorter job tenure need not mean reduced retirement benefits. In fact, a recent Society of Actuaries study found that about two-thirds of employees did better under a cash balance plan than under a traditional pension when costs were held constant. The percentage of women faring better under cash balance plans was even higher — about three-quarters — due to their tendency to have shorter job tenure.

Cash balance plans are also responsive to workers' desire for benefit portability. When workers with cash balance plans switch jobs, they can leave their assets in the plan (where they will continue to receive interest credits), can elect an annuity, or can roll over their account balance to their next workplace retirement plan or IRA. While these portability options are available in some traditional defined benefit pensions, they are much more broadly available under cash balance plans.

Employers also find that employee appreciation of traditional defined benefit pensions is limited because of their complexity and the fact that benefits in traditional plans are not expressed in the form of an account balance. This lack of employee appreciation undercuts one of the chief reasons for an employer to have a retirement plan — increased worker satisfaction — and has prompted many companies to question whether the traditional defined benefit plan is the best use of their benefit dollar. Cash balance plans — with their account and portability features — provide benefits that are more tangible and more appreciated by employees. Their visible value, portability and earlier accrual pattern can also make these plans a more effective recruitment device than traditional plans. Cash balance plans can be particularly effective in attracting today's highly-skilled workers who do not expect to remain with one employer for a career and who are looking to accrue meaningful retirement benefits from the very beginning of their worklife.

APPWP Voices Cash Balance Plans' Benefits
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In some instances, the change to a cash balance plan can reduce an employer's retirement benefit costs and this has been a relevant consideration for some companies. Business and competitive pressures, for example, can sometimes require the scaling back of benefit programs. But by no means is a conversion always driven by the desire to reduce costs. Whether or not a conversion to a cash balance plan will, in fact, reduce an employer's expenses depends on several factors, including the design of the old and the new plans, the extent of any transition benefits provided to employees, the nature of the employer's workforce, and any changes in other employee benefit programs. For example, a company with a significant number of younger, shorter-service employees that provides substantial transition benefits and an increased 401(k) match will typically face higher benefit costs in the wake of a cash balance conversion. Cash balance plans can also lead to higher retirement benefit costs when employers make the plan investments and improvements that they may have been unwilling to make to the prior, underappreciated traditional defined benefit pension. In a cash balance plan, such improvements are tangible — a larger account balance — and thus more likely to bring the desired result of enhanced employee satisfaction.

THE NUTS AND BOLTS OF CASH BALANCE CONVERSIONS

When a company converts to a cash balance plan, all employees are legally entitled to at least the benefit they have accrued in the prior plan as of the conversion date. Going forward, most employees will typically fare better than they would have under the traditional plan since the earlier, more even accrual pattern under cash balance plans will leave them with a greater benefit when they leave the job. For the longer service workers who may not do as well going forward, the extent of any difference in benefits will depend on the design of the old and new plans and the nature of the transition provisions that may accompany the conversion. Many employers spend considerable time designing transition provisions, especially for those workers who have reached or are approaching retirement eligibility. Transition arrangements vary, but can include "grandfathering" some or all employees in the prior pension plan either until retirement or for a period of time; providing some or all workers with additional amounts in their opening cash balance accounts; and providing some workers with additional benefit credits for a period of years or until retirement. Some employers also boost their match to a 401(k) plan when they institute a conversion, providing higher savings plan benefits to help offset any reduction in underlying pension benefits.

DISCLOSURE ACCOMPANYING CASH BALANCE CONVERSIONS

Recent media attention has raised the issue of what information employers provide to employees when they convert their pensions to cash balance plans. Concern has been expressed that the information provided to employees has in some instances been insufficient. APPWP believes the disclosure requirements of current law can be improved to remedy these concerns and ensure that employees are provided with useful information about how their retirement benefits are affected by a conversion to a cash balance plan.

Any legislation requiring enhanced disclosure for cash balance conversions should be crafted to provide employees with the information they need without creating an undue burden for employers and the pension system generally. In particular, enhanced disclosure

legislation should be designed so that it does not add unnecessarily to the high cost of plan administration that has already prompted many businesses to abandon the defined benefit pension system. Just since 1985, the number of defined benefit plans insured by the Pension Benefit Guaranty Corporation has dropped from 114,000 to 45,000. Cash balance plans offer many employers and employees an attractive design within the defined benefit system. At a time when policymakers are appropriately trying to revitalize this system, Congress should not unduly burden the defined benefit vehicle — the cash balance plan — that is meeting with success in today's marketplace.

Sensible disclosure legislation could be drafted in a number of ways. One reasonable approach is contained in H.R. 1102, a comprehensive pension reform bill introduced by Representatives Rob Portman (R-OH) and Ben Cardin (D-MD). Section 407 of H.R. 1102 would ensure that employees affected by a cash balance conversion receive a notification and description of any significant reduction in their benefits, rather than a copy or summary of the technical plan amendment that results in this reduction (which is what current law requires). We believe, however, that the disclosure legislation crafted by Senator Daniel Patrick Moynihan (D-NY) and Representative Jerry Weller (R-IL), S. 659/H.R. 1176, goes too far. The Moynihan/Weller legislation would require 20 detailed benefit calculations and projections for each affected employee, a process that would require the employer to gather and verify substantial information on potentially tens of thousands of individual workers. The legislation would apply this individualized comparative requirement not just to cash balance conversions but to a much broader range of defined benefit plan changes. APPWP believes this burdensome approach would have the unfortunate effect of deterring employers from using the cash balance design and accelerating employers' departure from the defined benefit pension system.

BENEFIT FLEXIBILITY MUST BE PRESERVED

While carefully crafted disclosure legislation may be appropriate, it would not be appropriate for Congress to restrict the ability of employers to change their retirement programs, whether from a traditional pension plan to a cash balance plan or in any other way. Our pension system is a voluntary one in which employers are encouraged to offer retirement benefits to their employees when doing so makes good business sense. Benefits that have *already* accrued receive protection under current law, but employees do not have any guarantee of or right to *future* benefit accruals. For many employers — including the vast majority of large employers — providing retirement benefits is, in fact, a key component of their compensation and business strategy. Yet if Congress were to restrict companies' right to change or eliminate their retirement plans, it would have a profound effect on employers' decisions to adopt or improve such plans. The consequence of plan initiation or improvement under such circumstances would be an ongoing financial obligation that could not be adjusted no matter the competitive or business pressures. If Congress were to limit employers' benefit flexibility in this way, the clear result would be reduced pension coverage — clearly an unfortunate outcome at a time when Members of Congress are working actively to expand the number of Americans with pension coverage.

CONCLUSION

Cash balance plans play an important role in our private retirement system as a defined benefit pension design that responds to the needs of today's businesses and workforce. Any concerns about such plans should be resolved in a careful and responsible fashion in order to avoid undermining this successful pension design and driving employers out of the defined benefit system altogether.

APPWP would welcome the opportunity to discuss cash balance issues in greater detail with interested offices. For more information, please contact James Delaplane, APPWP's Vice President, Retirement Policy, at 202-289-6700 or jdelaplane@appwp.org.

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The Association of Private Pension and Welfare Plans (APPWP — The Benefits Association) is the national trade association for companies concerned about federal legislation and regulations affecting all aspects of the employee benefits system. APPWP's members represent the entire spectrum of the private employee benefits community and either sponsor directly or administer retirement and health plans covering more than 100 million Americans.

July 15, 1999

Mr. William F. Sweetnam, Jr.
Senate Committee on Finance
219 Senate Dirksen Office Building
Washington, DC 20510-6200

Dear Mr. Sweetnam:

Following are my thoughts regarding your questions:

1) Should employees have detailed knowledge of their benefit under the old plan or is the new plan benefit information sufficient?

In order to prepare for retirement, employees need an estimate of their benefits from the employer's retirement plan(s) so they can determine whether that amount in conjunction with Social Security and other personal savings is enough. The amount of retirement benefits from the new plan is what is relevant regarding their future retirement. This along with the descriptions of the plan change and how the new plan will operate will allow employees to plan for retirement.

2) Will the provisions in the Pension Right to Know Act stop employers from adopting cash balance plans?

The defined benefit system is already under significant stress. Any legislation that adds complexity, significant burdens, and severe penalties would cause employers to consider a move away from the defined benefit system. When companies consider a change to the retirement plan, they often consider a defined contribution plan as one of the alternatives. The requirements of any new legislation would need to be factored into the decision on which alternative to choose. For some companies, burdensome legislation could be the deciding factor to exit from the defined benefit environment, including cash balance plans.

3) Should there be the same amount of expanded disclosure in all instances or should a lesser amount be required when it is clear to employees that the change decreases future benefits?

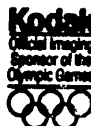
Some expanded disclosure is appropriate for all defined benefit plan changes so that employees can reasonably be expected to understand how the change might affect them. This could take the form of a plain English description of the change in cases where the effect of the change is obvious, such as changing the formula from 1.5% of pay to 1% of pay, eliminating participation of a group of people from the plan, or eliminating a bonus from the definition of compensation. Structural changes to the plan, such as a change from a traditional defined benefit to a hybrid plan, would need more disclosure since many employees might not understand the effect of this change. In this case, more explanations and perhaps some hypothetical examples would be appropriate.

If you would like to discuss these further or have any additional questions, please don't hesitate to call me at 716-724-1880.

Sincerely,

Rita D. Metras

Rita D. Metras
Director, Total Compensation



EASTMAN KODAK COMPANY • 343 STATE STREET • ROCHESTER, NEW YORK 14650

PREPARED STATEMENT OF RICHARD D. PEARCE

INTRODUCTION

Mr. Chairman, members of the Committee, thank you for inviting me today to testify on pension reform. My name is Richard D. Pearce. I am an Enrolled Actuary, Certified Pension Consultant and President of the Wilmington, Delaware office of Alliance Benefit Group, a pension consulting and actuarial firm. We presently provide retirement plan administrative services to over 250 small businesses in Delaware covering approximately 25,000 employees. Alliance Benefit Group is a nationwide consortium of pension consulting firms providing retirement plan administrative services to small businesses covering approximately 380,000 employees with retirement plan assets totaling over $4.5 billion dollars.

I also am a member and Past-President of the American Society of Pension Actuaries (ASPA) on behalf of whom I am testifying today. ASPA is an organization of over 4,000 professionals who provide actuarial, consulting, and administrative services to approximately one-third of the qualified retirement plans in the United States. The vast majority of these retirement plans are plans maintained by small businesses, and today I would like to focus on the myriad of rules and regulations which continue to make it exceedingly difficult for small businesses to offer meaningful retirement plan coverage to their employees.

THE SMALL BUSINESS RETIREMENT CRISIS

Everyone agrees on the problem. Americans, as a whole, are getting older and their retirement needs are growing. The number of Americans age 65 or older will double by 2030 (from 34.3 to 69.4 million) so that one in five Americans will be retired. As reflected in the current debate, the stress and strain on the current Social Security system will be significant.

However, even if the Social Security system remains strong through the 21st century, it will not be enough. Income from Social Security represents less than half of what the average American needs to retire comfortably. Meanwhile, according to recent surveys conducted by the Employee Benefits Research Institute one-third of the American workforce has not begun to save for retirement, and 75% of Americans believe they do not have enough retirement savings. Americans with low to moderate incomes are hardest hit since they are most likely to have no savings.

This highlights the need to expand and reform the private pension system. However, this need is especially acute with respect to small businesses. Since the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), the Congress has enacted layer upon layer of complex laws, and the Internal Revenue Service (IRS) has issued layer upon layer of complicated regulations seriously retarding the ability of small businesses to maintain retirement plans for their employees. In most cases these rules were enacted not in the interest of promoting retirement savings, but to raise revenue and to fund unrelated initiatives.

The effect of these costly rules and regulations on small business pension coverage is both dramatic and rather disturbing. The facts speak for themselves. According to a 1996 General Accounting Office study,(1) a whopping 87 percent of workers employed by small businesses with fewer than 20 employees have absolutely no retirement plan coverage. It's only slightly better for workers at small businesses with between 20 and 100 employees, where 62 percent of the workers have no retirement coverage. By contrast, 72 percent of workers at larger firms (over 500 employees) have some form of retirement plan coverage.

This significant disparity is made even more troubling by the fact that small business is creating the majority of new jobs in today's economy. As big firms go through corporate downsizing, many of the displaced workers find themselves working for small businesses. In fact, according to the Small Business Administration, 75 percent of the new jobs in recent years were created by small business. Small business now employs over half of the nation's workforce. However, because of the many impediments to small business retirement plan coverage, small business employees will often find themselves without a meaningful opportunity to save for retirement.

The Retirement Savings Opportunity Act (S.649), introduced by you, Mr. Chairman, and Senator Baucus (D-MT), and The Pension Coverage and Portability Act (S. 741), introduced by 11 members of this committee, including Senators Graham (D-FL), Grassley (R-IA), Baucus (D-MT), Hatch (R-UT), Breaux (D-LA), Jeffords (R-VT), Robb (D-VA), Mack (R-FL), Chafee (R-RI), Thompson (R-TN), and Murkowski (R-AK), contain numerous provisions which, if enacted, would have a substantial and immediate impact on small business retirement plan coverage. Throughout my testimony I will highlight some of the more significant of these provisions.

ROADBLOCKS AND SOLUTIONS TO SMALL BUSINESS RETIREMENT PLAN COVERAGE

1. Retirement Plan Limits

Since ERISA was enacted, Congress has placed significant limits and caps on retirement plan contributions and benefits. Although these provisions were enacted under the false premise of reducing the benefits of high-paid individuals, they have actually served to reduce the benefits of rank-and-file employees.

Let me begin with one specific type of limitation problem. Under current law, total annual contributions to a defined contribution plan on behalf of any employee may not exceed the lesser of 25% of compensation or $30,000. In addition, there are limitations on the deductions that can be taken by companies for contributions to a retirement plan.

There's an outstanding construction management company in Wilmington, Delaware, called EDIS, whose situation provides a real-life example of the problems caused by this current-law limitation on retirement benefits.

Andy DiSabatino is a fourth-generation chief operating officer of his family's construction management firm. His company places a very high value on its employees, and the firm has always provided fairly generous retirement plans for its staff. In addition to a money purchase pension plan providing consistent annual retirement plan contributions, the company has also maintained a discretionary profit sharing plan to provide supplemental contributions to their employees in profitable years. The company has historically made significant contributions to this plan on a fairly consistent basis; however, being in a cyclical industry, they have simply not been in a position to contribute to this plan each and every year.

Andy decided that he would like to offer his staff an opportunity to save on their own on a tax-efficient basis. This would assure that the employees would not be short-changed if the company were to go through a long period of low-profits. To accomplish this, Andy implemented a 401(k) plan that was funded by a combination of voluntary salary deferrals and employer matching contributions. Andy had no plans to abandon the profit sharing plan. Quite to the contrary, Andy intended the 401(k) plan to be merely a supplement to the existing profit sharing and money purchase plans.

Andy's employees enthusiastically embraced the new 401(k) plan. The average deferral percentage under the plan for the 1998 calendar year was more than 7% of salary, and this generated an employer matching contribution that totaled another 3% of pay. The money purchase plan contributions for 1998 were slightly more than 9% of eligible compensation. When you add these 3-pieces together, total contributions on behalf of employees under these two plans were 19% of salary.

The company had a successful year in 1998, and Andy wanted to reward the employees with a generous contribution to the company's profit sharing plan. But here's how the deduction rules work. The 15% profit sharing limit is based on net compensation after salary deferrals. After you subtract the 7% average salary deferral from eligible salary, this reduces the overall profit sharing limit to about 14% of pay. You then have to subtract the participant salary deferrals and employer matching contributions from that amount to determine the maximum profit sharing contribution. When we finished with the arithmetic, less than 4% of pay was left for the profit sharing plan. And several participants would not be able to receive even that small amount because when you count their 401(k) plan salary deferrals they had already hit the 25% allocation limit under IRC Section 415(c). Andy decided that since not everyone could benefit from the profit-sharing plan it was not worth contributing at all, and the company has taken steps to discontinue the profit sharing plan altogether.

Andy never intended to penalize employees for participating in the 401(k) plan, but because of the way the deduction limits work, that's exactly what's happened. This seems a very mixed message to send to participants: "We want you to save for retirement, but if you do, the government says we have reduce the amount your employer can put aside for you."

This particular situation would be corrected under both the Pension Coverage and Portability Act and the Retirement Savings Opportunity Act where the 25% of compensation limitation would be repealed, and employees' own elective deferrals would not count against the corporate deduction limitation. ASPA urges you to enact these provisions as soon as possible so good employers can provide the best retirement benefits for their employees.

2. Safe Harbor Defined Benefit Plan

In the typical lifespan of a small business, it generally takes a number of years before a small business has the resources to establish a retirement plan. In my experience this does not usually occur until the small business owner is in his or her

mid-40s and most likely both the owner and the workers have not previously been covered under a retirement plan. Consequently, they are getting a late start on their retirement savings, and a defined contribution plan—like the SIMPLE plan—may not offer enough savings to produce an adequate retirement income.

Here is a straightforward example. Assume a small business adopts the SIMPLE plan. One of the workers who has been with the small business for 10 years is 45 years old when the SIMPLE plan is adopted and currently earns $40,000 annually. If this worker and his or her employer contribute 10 percent of pay annually to the plan until retirement at age 65, and the plan's investment return is 7 percent per year, the worker can expect to retire with an annual pension of approximately $18,000, only about 45 percent of his salary. Most retirement planning professionals will tell you that a retirement income replacement ratio of between 60 to 70 percent of final average salary is a good rule of thumb when determining whether a retirement benefit is adequate.

But what about inflation? If this worker receives an annual salary adjustment of 4 percent per year and continues to contribute 10 percent of pay to the SIMPLE plan, the worker will only accumulate enough money to fund an annual pension benefit equal to 32 percent of final salary. By contrast, defined benefit plans can provide greater benefits at no greater cost to the employer. How? By anticipating salary increases in the plan's funding assumptions, the employer contributes more dollars to the plan in the early funding years. Because of this, more investment earnings are realized by the plan, and better benefits can be delivered to the employee.

Despite the success of the SIMPLE plan, retirement plan coverage for small business workers continues to be inadequate because of the limitations on contributions to the SIMPLE plan. The administrative burdens and high costs associated with other qualified retirement plans providing greater benefits make it extremely difficult for small business to maintain such plans. In addition, small business workers who are baby boomers and who have not previously been covered under retirement plans will not be able to save enough under the SIMPLE plan or a 401(k) plan to provide an adequate retirement income. ASPA believes small business needs a safe harbor defined benefit retirement plan to complement the SIMPLE plan which is easy to administer and which will provide small business employees, including baby boomers, a sufficient retirement benefit.

Both the Pension Coverage and Portability Act and the Retirement Savings Opportunity Act create a new safe harbor defined benefit retirement plan for small business called the Secure Assets for Employees (SAFE) Plan. This will provide all small business employees with a secure, fully portable, defined retirement benefit they can count on without choking small business with complex rules and regulations small business cannot afford.

3. Other Impediments to Defined Benefit Plan Coverage

a. Full Funding Limit

The present-law funding limits, for defined benefit plans, are a prime example of how overbroad legislation can have a disastrous effect on small business retirement plan coverage. In 1987, the full funding limit—the limit on the amount an employer is allowed to contribute to a defined benefit plan—was substantially reduced. The changes were made solely to raise revenue and had nothing to do with retirement policy. As an actuary, I can tell you that the current law full funding limit seriously impairs the funded status of defined benefit plans and threatens retirement security because it does not allow an employer to more evenly and accurately fund for projected plan liabilities. One way to conceptualize the problem is to compare a balloon mortgage to a more traditional mortgage which is amortized over the term of the loan. The full funding limit causes plan funding to work more like a balloon mortgage by pushing back necessary funding to later years. This is particularly harsh on small business because a small business does not have the cash reserves and resources that a large firm has, and so would be better off if it could more evenly fund the plan. Even worse for small business, a special rule in the Internal Revenue Code relaxes the full funding limit somewhat, but only for larger plans (plans with at least 100 participants). Once again this appears to be a vestige of the view that small business plans are just for doctors and lawyers.

Small business owners are aware of the present-law funding limits on defined benefit plans, and that is why small businesses with defined benefit plans are trying to get rid of them and new small businesses are not establishing them. From 1987, when the full funding limit was changed, to 1993—a period which saw a significant increase in the number of small businesses established—the number of small businesses with defined benefit plans dropped from 139,644 to 64,937.(2) That is over a 50 percent decline in just seven years.

To reverse this trend, ASPA strongly believes that the full funding limit should be repealed to allow for more secure funding. Repeal of the full funding limit is supported by wide variety of organizations representing the entire spectrum of views pertaining to retirement policy. Repeal is supported by organizations representing unions, participants, employers, financial institutions and retirement professionals. It is also supported by the Pension Benefit Guaranty Corporation, which as you know is responsible for guaranteeing workers retirement benefits.(3)

The repeal of the full funding limit is included in both the Pension Coverage and Portability Act and the Retirement Savings Opportunity Act.

b. Reduced PBGC Premiums for New Small Business Plans

Imagine if you had to pay premiums on a life insurance policy based on a $100,000 benefit, but that the policy only paid a $50,000 benefit. No sensible consumer would purchase such a policy. However, that is in fact what often occurs when a small business adopts a new defined benefit plan.

Let me explain. If a newly created defined benefit plan gives credit to employees for years of service prior to adoption of the plan, the tax code funding rules limit, in the early years of the plan, how much can be contributed to the plan to fund the benefits associated with this past service credit. Consequently, the new plan is treated as "underfunded" for PBGC premium purposes and the plan is subject to a special additional premium charged to underfunded plans. This premium is assessed even though the premium is based on benefits which exceed the amount the PBGC would pay out if they had to take over the plan. In other words, the small business is forced to pay premiums to insure benefits that exceed what the PBGC will guarantee.

This additional premium can amount to thousands of dollars and is a tremendous impediment to the formation of small business defined benefit plans. Fortunately, both Congress and the Clinton Administration have recognized this problem. The President's pension proposals and the Pension Coverage and Portability Act include a provision that would reduce PBGC premiums for new small business defined benefit plans to $5 per participant for the first five years of the plan. Given the pressing need to expand pension coverage for small business employees, particularly defined benefit plan coverage, ASPA hopes this legislation can be enacted as soon as possible.

4. Roth 401(k) and 403(b) Plans

The Retirement Savings Opportunity Act also includes an innovative provision which allows 401(k) and 403(b) plan participants to choose their tax treatment. Under current law, defined contribution plans are generally allowed to receive after-tax contributions. However, allocable income on such contribution is subject to income tax when distributed.

Under the proposal participants could choose to treat their contributions like contributions to a Roth IRA (i.e., as after-tax contributions not included in income when distributed if held for five years). ASPA believes this exciting new proposal will encourage many small businesses to offer these plans to their employees, and we support its enactment.

5. Other Proposals Expanding Small Business Retirement Plan Coverage I would like to highlight a few other provisions that, if enacted, would expand small business retirement plan coverage.

a. Tax Credit for Start-up Costs

According to surveys of small businesses, high administrative costs are one of the chief reasons small businesses do not adopt a retirement plan. Two provisions in the Pension Coverage and Portability Act and the Retirement Savings Opportunity Act would greatly alleviate this problem. A 50% tax credit would be given for administrative expenses incurred in connection with a new small business retirement plan. The credit would be for expenses up to $2,000 for the first year and $1,000 for the second and third years.

In addition, small businesses with 50 employees or less, who adopt a new retirement plan would be eligible for an annual tax credit equal to 50% of employer contributions with respect to non-highly compensated employees, up to a maximum of 3% of such employee's compensation. ASPA believes both of these credits would significantly encourage small businesses to adopt retirement plans for their workers.

b. Top Heavy Rules

Top-heavy rules are among the rules which grew from a bias that small business plans were only established by wealthy professionals (e.g., doctors and lawyers) and that only the professional received any benefits under these plans. This is simply

not the case in today's workforce. According to the Small Business Administration, less than 10% of small firms today are in the legal and health services fields. Small business includes high technology, light industrial, and retail firms which have stepped into the void created by the downsizing of big business. The same rules targeted at the doctors and lawyers also negatively affect these burgeoning small businesses.

The top-heavy rules are not relevant for large firm (over 500 participant) plans. They only affect plans maintained by small business. The top-heavy rules look at the total pool of assets in the plan to determine if too high a percentage (more than 60%) of those assets represent benefits for key employees, namely the owners of the small business. How much the small business owner makes is not relevant. Even if the small business owner is making only $30,000, the plan can still be considered "top-heavy." Because it is a small business, the likelihood of a small business plan being top-heavy is greater because you are spreading the pool of plan assets over a smaller number of workers. This problem is made worse when a family member of the owner works in the small business because the top-heavy rules discriminate against family-owned small businesses by treating all family members as key employees no matter what their salary.

If a plan is top-heavy, the small business must make special required contributions which substantially increase the cost of the small business plan. According to a survey of small businesses conducted by the Employee Benefit Research Institute, these required contributions were the number one regulatory reason why small businesses did not maintain a retirement plan for their employees.

Simply put, the excessive fascination with doctors and lawyers has left the majority of small business employees out in the cold with respect to retirement plan coverage. The Pension Coverage and Portability Act contains several provisions which will bring some sense to the overly burdensome top-heavy rules. In particular, these changes will allow small businesses, even if they employ some family members, to offer a basic 401(k) plan to their employees. It's time to give small businesses that want to provide retirement benefits for their employees an extra break not an extra burden.

CONCLUSION

As early as President Carter's Commission on Pension Policy in 1981, there has been recognition of the need for a cohesive and coherent retirement income policy. ASPA believes there is a looming retirement income crisis with the convergence of the Social Security trust fund's potential exhaustion and the World War II baby boomers reaching retirement age. Without a thriving pension system, there will be insufficient resources to provide adequate retirement income for future generations. In particular, four elements have converged to create this crisis:

- The baby boomer population bubble is moving inexorably toward retirement age.
- Private savings in the United States has declined dramatically.
- Many employees, particularly small business employees, continue not to be covered by qualified retirement plans.
- In the absence of major changes, our Social Security system is headed for bankruptcy.

During the years 2011 through 2030, the largest ever group of Americans will reach retirement age. Without a change in policy or practice, many in this group will find themselves without the resources to be financially secure in retirement. Most pension practitioners will tell you that the constantly changing regulatory environment has created more complexity than most employers are willing to bear; consequently, coverage under qualified retirement plans has dropped. The problem has affected small businesses most severely—they have fewer resources to pay the compliance costs and must spread those costs over fewer employees. During the early decades of the next century, the ratio of workers to retirees will be significantly lower than it is today. The shrinking ratio of workers who pay Social Security to those drawing benefits makes it likely that future retirees will have to rely more on individual savings and private pension plans and less on Social Security.

We believe there is need for constructive pension reform, particularly with respect to small business retirement plan coverage. We believe the time has come to enact legislation like the Pension Coverage and Portability Act and the Retirement Savings Opportunity Act, which will provide an opportunity for all working Americans, including small business employees, the opportunity to obtain financial security at retirement. We look forward to working with you Mr. Chairman, and the other members of the Finance Committee, to move these bills through the legislative process.

1. General Accounting Office, *401(k) Pension Plans—Many Take Advantage of Opportunity to Ensure Adequate Retirement Income* Table II.3 (August 1996).
2. U.S. Department of Labor, *Private Pension Plan Bulletin—Abstract of 1993 Form 5500 Annual Reports* Table F2 (Winter 1997).
3. The Advisory Council on Social Security also urged in its report that the full funding limit be modified to allow better funding of private pension plans. Report of the 1994-1996 Advisory Council on Social Security, *Volume I: Findings and Recommendations* 23 (January 1997).

Statement of

Patrick J. Purcell
Specialist in Social Legislation
Congressional Research Service

Testimony before the Senate Committee on Finance

June 30, 1999

"Cash Balance Pension Plans"

During the 1990s, both the number and proportion of American workers who participate in employer-sponsored pensions or retirement savings plans have increased. Data from the Bureau of the Census show that between 1990 and 1997, the number of workers between the ages of 20 and 64 who participate in such plans rose from 51 million to 58 million, representing an increase in coverage from 47% of the civilian work force to 49%. At the same time, there has been a shift in coverage away from traditional "defined benefit" pensions toward "defined contribution" plans, such as those authorized under section 401(k) of the tax code. Defined benefit plans typically pay a lifelong annuity based on years of service and final pay. Defined contribution plans operate much like savings accounts in which contributions from employers and employees accumulate on a tax-deferred basis during the employee's working years. The retirement benefit in a defined contribution plan depends on the value of the account when the employee reaches retirement. According to the U.S. Bureau of Labor Statistics, coverage by defined benefit pensions in firms with 100 or more workers fell from 59% of employees in 1991 to 50% 1997. During the same period, the proportion of workers in these firms who participated in a defined contribution plan rose from 48% to 57%.

What is a "cash balance plan"? In recent years, many employers have modified their traditional defined benefit pensions so that they have some of the characteristics of defined contribution plans. The most common of these so-called "hybrid" pensions are cash balance plans. Press reports over the past several months have quoted industry sources as saying that more than 500 medium and large firms have adopted cash balance plans, covering between 7 million and 10 million workers. What is a cash balance plan? Rather than defining an employee's accrued benefit as a stream of monthly payments based on years of service and final pay as a traditional plan would, a cash balance plan defines an employee's benefit as an account balance to which pay and interest credits are periodically contributed by the employer.

In a cash balance plan, the employer contributes a percentage of pay into an employee "account" and credits interest to the account at whatever rate or index of rates the employer chooses. Many firms peg their interest credits to the yield on 1-year U.S. Treasury Bills or the interest rate paid by 30-year Treasury Bonds. Employees receive periodic statements of their accumulated pay and interest credits, but unlike a defined contribution plan such as a 401(k), these employee "accounts" are merely bookkeeping devices: all of the assets of a cash balance plan are commingled in a pension trust managed by the employer or its designated trustee. Vested employees have the legal right to receive retirement benefits from a cash

balance plan, but it is the employer that owns the plan's assets. Any appreciation of the plan's assets beyond the rate of interest that the employer has promised to credit to employee accounts can be used by the employer to make future pay and interest credits to employee accounts.

Because the assets of cash balance plans are commingled rather than separated into individually-owned accounts, these plans are classified under federal law as *defined benefit* pension plans. The Internal Revenue Code designates plans that provide individual accounts for each participant and pay benefits based solely on the contributions to the accounts and subsequent investment gains or losses as *defined contribution* plans. Any plan that does not fit this definition is a defined benefit plan.[1] The individual accounts in a cash balance plan are merely *hypothetical* accounts used to describe an employee's accrued benefit. They are not *employee-owned individual accounts.*

Reasons for the Growing Popularity of Cash Balance Plans. Cash balance plans have become popular both among employers seeking to reduce their pension-related expenses and among those who wish to spread current pension expenditures more evenly over their work force. Converting a traditional pension plan to a cash balance plan will not necessarily reduce a firm's pension expenses. Nevertheless, a conversion to a cash balance plan can be designed to result in lower pension expenses if that is a priority for the plan's sponsor. Because benefits in traditional defined benefit plans are typically based on final average pay, the cost to an employer of funding these benefits can rise steeply as an employee approaches the plan's normal retirement age. In contrast, benefits in a cash balance plan accrue based on career-average pay rather than final-average pay. Funding expenses, therefore, are more level throughout an employee's tenure. Furthermore, in a cash balance plan the employer promises only to make regular pay and interest credits to the plan rather than to replace a specific percentage of final pay. Employers can set the pay and interest credits at levels that reduce their total expenses compared to their previous defined benefit pension plan.

Another reason that cash balance plans have become popular is an increasing concern among employers that traditional pensions, designed mainly for the benefit of employees who spend 25 or 30 years with one employer, are ill-suited to, and not sufficiently valued by, younger employees in a highly mobile workforce. Cash balance plans can be attractive to younger workers because the benefit is described in terms of an account balance — similar to a defined contribution plan like a 401(k) — and because the sponsors usually pay accrued benefits to employees who depart before retirement in the form of a lump-sum distribution. Moreover, a larger proportion of total lifetime benefits accrue early in one's career under a cash balance plan than under a traditional pension based on final average pay. Younger workers might therefore place a higher value on a cash balance plan than they would on a traditional pension in which the bulk of benefits accrue in the years just before retirement.

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[1] 26 USC §§ 414(i) and 414(j).

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"Front-loading" vs. "Back-loading" of Benefits. Traditional defined benefit pensions are sometimes described as being "back-loaded" because they typically compute a retiring worker's benefit based on his or her *final average pay*, such as average salary in the last 5 years of employment. In this kind of plan, workers accrue a substantial proportion their pension benefits in the last few years before retirement, and the cost to an employer of funding pension benefits can rise steeply during these years. Retirement benefits under a cash balance plan, in contrast, accrue based on *career-average pay*, and employer costs rise less steeply over time. The final value of benefits accrued in a cash balance plan depend crucially on the rate of interest the employer credits to the plan and the number of years over which the interest credits are compounded. Because pay and interest credits received early in a worker's career have more years during which to accrue further interest credits, cash balance plans are in effect "front-loaded" pension plans. Workers who are converted to a cash balance plan at mid-career will have spent the early part of their working lives in a *back-loaded* plan and their later working years in a *front-loaded* plan, thus enjoying the full benefits of neither. For this reason, some employers who have converted their pensions to cash balance plans have allowed workers with long periods of service to remain under the old plan.

Questions of Age Discrimination. Some pension analysts have raised questions as to whether cash balance plans discriminate against older employees because interest credits compound over fewer years for these workers, resulting in lower benefits at the normal retirement age compared to a younger employee with the same initial account balance. The Employee Retirement Income Security Act (ERISA) and the Age Discrimination in Employment Act prohibit discrimination on the basis of age in employee benefit plans. Neither the IRS nor the Department of Labor has indicated publicly that cash balance plans conflict with these statutes. Moreover, since cash balance plans were first developed in the mid-1980s, hundreds of employers have received determinations from the IRS that their cash balance plans qualify for income tax deductions and deferrals.

Lump-sum Payment Option. An employee covered by a cash balance plan who separates from an employer prior to retirement usually is given the option of taking a lump-sum distribution from the plan. This option gives employees who change jobs the opportunity to re-invest their accumulated retirement benefits. It also relieves the employer of a long-term financial liability, an ongoing administrative expense, and the obligation to pay insurance premiums to the Pension Benefit Guaranty Corporation for former employees. Employers can pay accrued benefits to departing employees as a lump-sum under traditional pension plans, too; accrued pension benefits can be calculated at any point during a worker's career under both traditional defined benefit plans and cash balance plans. In practice, however, many employers pay lump-sum distributions from traditional pension plans only if the present value of the accrued benefit is less than $5,000. In either a traditional defined benefit plan or a cash balance plan, if the present value of the benefit is more than $5,000 it can be paid as a lump sum only with the written permission of the employee and his or her spouse.

Employer-directed Investment. The investment earnings of the pension trust containing the assets of a cash balance plan may be more or less than the interest rate credited to the employee accounts. If the earnings of the trust are less than the rate

of interest promised by the plan, the employer is legally obligated to make up the difference. Thus, as in a traditional defined benefit pension, the employer bears the financial risk associated with unpredictable changes in the value of the plan's assets. On the other hand, the employer will benefit from rates of return on the plan's assets that exceed the interest rate it has promised to credit to employee accounts. Any excess over the rate of return needed to credit the employee accounts can be used by the employer to make future credits to the accounts. This contrasts with defined contribution plans, in which the employee bears the risk that the account may lose value, but in which he or she also keeps any investment gains. Moreover, converting a traditional defined benefit pension to a cash balance plan can result in a plan that was underfunded becoming fully funded because of the difference in the expected rate of return on the plan's assets and the interest rate credited to employee accounts. Some employers who have converted traditional defined benefit plans to cash balance plans have been able to suspend their contributions to the pension plan, making the required pay and interest credits from excess pension fund assets.

Disclosure Issues. Recently, in trade journals and at forums on employee benefits, consultants have emphasized the importance of addressing workers' anxieties about pension conversions by keeping them informed about the process. ERISA requires pension plans to notify participants of any amendment that will result in a significant reduction in the rate of future benefit accrual at least 15 days before the amendment takes effect.[2] Some employers have distributed detailed information to their employees describing how the transition to a cash balance plan will affect their individual retirement benefits, while others have provided only a general description of the plan amendments. Employees who know the value of their benefits under the old plan and the rate at which they will accrue benefits under the new plan are better able to decide how to respond to the change. Some might wish to save more on their own. Others might prefer to move to another job. S. 659, introduced by Senator Moynihan and H.R. 1176, sponsored by Congressman Weller, would expand the disclosure requirements for pension plans with 1,000 or more participants that are amended to reduce the rate of future benefit accruals.

Setting the Initial Account Balance. ERISA prohibits employers from reducing pension benefits that have already been accrued, but they may reduce the rate at which *future* benefits will accrue.[3] Consequently, the employer can set the initial value of a cash balance account at any amount, provided that separating employees who take a lump-sum are paid the greater of the present value of their accrued benefit under the old plan and the present value of the cash balance account. Some employers set the initial value of a cash balance account equal to the present value of the benefits an employee had accrued under the firm's traditional defined benefit plan. However, if the initial value of a cash balance plan is established at less than the employee's accrued benefit under the old plan, the employee ceases to earn *new* pension benefits until subsequent pay and interest credits equalize the value of the two plans. Pension analysts call this period when no new benefits accrue a "benefit plateau" or "wear-away" because even if the employer begins to apply pay and interest credits to the cash balance account immediately, employees must "wear

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[2] 29 USC § 1054(h).

[3] Changes in pension plans for union members are subject to collective bargaining.

away" the difference between the starting account balance and the value of their benefit under the old plan before new benefits begin to accrue. Why would an employer set the opening value of a cash balance plan lower than the present value of the benefit accrued under the firm's old plan? By setting a low opening balance, the employer can apply future pay and interest credits to employee accounts from money that is already in the pension fund. In such cases, an employer might go several years without making additional contributions to the plan.

If an employer sets the opening balance of an employee's hypothetical cash balance account equal to the present value of benefits accrued under the traditional plan, there is no "benefit plateau," and the employee begins to accrue new pension benefits immediately. Employees also will begin to accrue new benefits immediately if they are all given an initial cash balance account of zero. Some firms that have followed this method have put the benefits that employees accrued under the old plan into an interest-bearing account so that these benefits, too, will continue to increase in value. Even without this so-called "benefit plateau," employees who are converted to a cash balance plan at mid-career can suffer substantial reductions in the pension benefits that they will have accrued by the time they reach retirement age because they will not experience the rapid accrual of benefits in the years immediately before retirement which typically occurs in traditional defined benefit plans.

Choosing an Interest Rate. When choosing the rate at which interest will be credited to employee accounts in a cash balance plan, an employer will likely consider several factors:

- A low interest rate will directly reduce the cost of interest credited to employee accounts.

- A low interest rate will increase the potential "interest-rate spread" between the rate paid on employee accounts and the rate at which the fund's assets actually appreciate.

- As I will explain, a low interest rate increases the likelihood that the firm will have the option to pay employees who separate before retirement lump-sum distributions that are *less* than the face-value of the employees' cash balance accounts. (This can occur if the plan credits interest to employee accounts at a lower rate than the rate that federal law requires pension plans to use when valuing lump-sum distributions).

Several recent articles in trade journals of the pension industry have noted the criticism that the rate of interest credited to participants in cash balance plans can be significantly less than the actual rate of return on the assets held in the pension trust. This arrangement has been defended by some plan sponsors as reasonable because the employer bears the risk that actual returns could be lower than the interest rate promised to participants, in which case the sponsor is legally required to make up the difference from its own resources. Some other sponsors, however, have responded by adopting amendments that promise plan participants at least a specified minimum rate of return plus a share of any return on the trust's assets that exceeds that minimum.

Valuation of Lump-Sum Distributions Because cash balance plans are *not* individual accounts owned by the employee, the value of a vested employee's accrued benefit — and the amount of a lump-sum distribution from the plan — is legally determined by the sections of ERISA and the Internal Revenue Code that govern *defined benefit plans*. The difficulty in valuing lump-sum distributions from cash balance plans is that the federal statutes governing these plans describe the accrued benefit in very different terms than the plans themselves use. Whereas cash balance plans describe accrued benefits in terms of an "account balance," the relevant federal statutes describe accrued benefits in *all* defined benefit plans in terms of an "annual benefit commencing at normal retirement age."[4] The law requires that any other form of payment must be "the actuarial equivalent of such benefit."[5] Determining the value of a lump-sum distribution from a cash balance plan in compliance with ERISA and the tax code, therefore, depends on the meaning of the terms "accrued benefit" and "actuarial equivalent of such benefit" as they apply to cash balance plans.

ERISA protects departing vested employees who receive lump-sum distributions from being paid less than the *present value* of the benefit that would be payable at the plan's normal retirement age. Federal regulations prescribe the methods for valuing lump-sum distributions from traditional DB plans and the IRS has published regulatory guidance for valuing lump-sum distributions from cash balance plans.[6] Under the regulatory guidance published by the IRS, the employer must project the cash balance account forward to the plan's normal retirement age using the interest rate or index of rates set forth in the plan documents. This amount must then be discounted to the present, using the interest rate paid by 30-year U.S. Treasury bonds in the month prior to the distribution.[7] A departing employee must be paid the greater of the present value of the cash balance account as determined by this method and the present value of benefit that he or she had accrued under the old plan.

If the interest rate credited to a cash balance plan by an employer differs from the 30-year Treasury bond rate, then the present value an employee's accrued benefit can be more or less than the nominal value of pay and interest credits that have been allocated to the employee's account. If the employer credits interest to a cash balance plan at a *higher* interest rate than the plan is required to use for valuing lump-sum distributions, then the present value of the accrued benefit will be *greater* than the nominal account balance. The plan must pay the greater of these two amounts if a departing employee takes a lump-sum distribution. If interest is credited to the plan at a *lower* rate than is used for lump-sum valuations, then the present value of the accrued benefit will be *less* than the face value of the account, and the employer can legally pay the lesser amount as a lump-sum distribution.[8] A pre-retirement

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[4] 26 USC § 411(a)(7)

[5] 26 USC § 411(c)(3)

[6] 26 CFR 1.411(a), 26 CFR 1.417(e), and IRS Notice 96-8 (Bulletin 1996-6).

[7] Use of the interest rate on 30-year Treasury bonds for valuing lump-sum distributions is prescribed by section 767 of the *Retirement Protection Act of 1994* (P.L.103-465).

[8] Consider, for example, a departing 50-year-old employee who takes a lump-sum (continued...)

lump-sum distribution from a cash balance plan will need to be the same as the face-value of an employee's cash balance account *only* if these two interest rates are equal.

Employer valuations of lump-sum distributions from cash balance plans have been the source of at least two lawsuits recently decided in federal courts in Vermont and Georgia. In both cases the plaintiff claimed that the distribution was less than the amount owed by the plan and in both cases the Federal District Court ruled in favor of the employer.[9] The value of lump-sum distributions from cash balance plans is likely to be a continuing source of disagreement because the pertinent statutes were written with reference to traditional defined benefit pensions. Moreover, the Federal District Court in Atlanta, while dismissing the plaintiff's claim for a larger lump-sum distribution from a cash balance plan, ruled that the relevant Treasury Department regulations are "unreasonable."

IRS Notice 96-8 An accrued benefit and its actuarial equivalent under a traditional defined benefit plan can be determined for an employee of any age by applying the plan's benefit formula and the prescribed interest rate and mortality assumptions.[10] The Internal Revenue Service has addressed the issue of lump-sum distributions from cash balance plans in Notice 96-8, published in February 1996.[11] The notice states that the accrued benefit under a cash balance plan includes the value of interest credits *up to the plan's normal retirement age*. These interest credits comprise part of the nonforfeitable portion of the present value of the employee's accrued benefit, as interpreted by the IRS. In other words, when determining the present value of an employee's accrued benefit (the present value being the "actuarial equivalent" of an annuity beginning at the plan's normal retirement age) the employer must project the account balance forward to the plan's normal retirement age, including the periodic interest credits that have been promised to plan participants.[12] The *present value* of the accrued benefit will be same as the *nominal value* of the cash balance plan only if the same interest rate is used to project the account forward to normal retirement age and discount it back to the present. The interest rate credited to employee

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(...continued)
distribution from a cash balance plan that has a normal retirement age of 65 and that credits interest monthly at the rate paid on 1-year U.S. Treasury Bills (recently 4.7% per annum). Assume the account has a current nominal value of $50,000. This amount must be projected forward for 15 years at 4.7% and then discounted to the present at 5.6% (the recent yield on new 30-year U.S. Treasury bonds). The result is a present value of $43,711.

[9] *Esden v. The Retirement Plan of the First National Bank of Boston*, U.S. District Court for the District of Vermont (File No. 2:97-CV-114, Sept. 28, 1998) and *Lyons and others v. Georgia-Pacific Corporation Salaried Employees Retirement Plan and Georgia-Pacific Corporation*, U.S. District Court for the Northern District of Georgia (File No. 1:97-CV-0980, March 22, 1999). Both cases have been appealed to the Circuit Courts for their respective districts.

[10] 26 USC § 417(e)(3)

[11] 26 CFR § 1.411(a), 26 CFR § 1.417(e), and IRS Notice 96-8 (Bulletin No. 1996-6).

[12] One employer has at least temporarily avoided the necessity of projecting interest credits into the future and then discounting them to the present by establishing its "normal retirement age" as age 65 or after five years tenure, whichever comes first. The IRS is currently evaluating whether such a policy complies with ERISA.

accounts is chosen by the employer, but the discount rate is prescribed by federal law. Consequently, there may be many instances in which the two rates differ.

The practical effect of the IRS regulation prescribing the method for valuing lump-sum distributions from cash balance plans is that any employer who credits interest to a cash balance plan at a rate *higher* than the rate paid by 30-year Treasury bonds may be legally obligated to pay a pre-retirement lump-sum distribution that is *more* than the nominal value of an employee's cash balance account. Conversely, an employer who credits interest to a cash balance plan at a rate *lower* than the rate paid by 30-year Treasury bonds may legally pay a pre-retirement lump-sum distribution that is *less* than the nominal value of an employee's cash balance account. Such differences between the *nominal* value of a cash balance account and the value of a *lump-sum distribution* from the account will occur whenever the interest rate credited to participants by the employer differs from the rate at which employers are required by law to calculate the *present value* of an employee's *accrued benefit.*

Many employers may be unaware that in some instances they may be obligated to a pay lump-sum distribution in excess of the nominal value of a cash balance account, and that in other situations they may legally pay a lump-sum distribution that is less than the nominal value of the account. Most employees in cash balance plans likewise have yet to discover that if they separate from their employer prior to retirement and elect to take a lump-sum distribution they may in some circumstances be entitled to receive more than the amount of pay and interest credits attributed to their "accounts," while in other cases they may legally be paid less than this amount. That there is any uncertainty about the amounts that employers are legally obligated to pay as lump-sum distributions from cash balance accounts — and that vested employees are legally entitled to receive — results mainly from the application to these plans of statutory language that was developed with reference to traditional defined benefit pensions. In light of the rapid adoption of cash balance pension plans by employers, and given the likelihood of future litigation between plan participants and pension administrators, many observers have called for legislation that would clarify the meaning of pertinent sections of ERISA and the Internal Revenue Code as they apply to these plans.

PREPARED STATEMENT OF LOU VALENTINO

Mr. Chairman and Members of the Committee, my name is Lou Valentino. I am the head of the National Defined Contribution Administrative Practice at Watson Wyatt Worldwide. I am here today as Vice President of the National Defined Contribution Council (the NDCC) and Chairman of the NDCC Government Relations Committee. With me today is Phil Lin, Vice President and Associate General Counsel of Delaware Management Company.

Let me start by commending you and your colleagues for your leadership on this vitally important topic and for holding this hearing. It is no coincidence that Webster's College Dictionary now includes a definition of the Roth IRA, which is fast becoming synonymous with the phrase "tax-free retirement savings." The vigilance of you and your colleagues in pursuing tax incentives for retirement savings is truly historic and must continue.

The National Defined Contribution Council or NDCC is an organization which promotes pension savings primarily through employee-directed investment programs. Together, NDCC's members manage and administer over 75% of all defined contribution or "DC" retirement plans in the United States. In Washington, D.C., our Government Relations Committee has provided technical support and practical insight to legislators and regulators in our areas of expertise. While promoting savings for all Americans, our main purpose in evaluating legislation is to make sure pension legislation is simple and administerable, so that it works as intended in the real world.

Americans need to do more to save for retirement. You know it and we know it. Rather than reciting a litany of data evidencing this plain fact, I would like to spotlight the need for Congress to implement serious and significant pension reform as a means of addressing the problem.

Accordingly, our main comment today is to encourage you to make pension reform the "centerpiece" of the tax bill this committee is expected to mark up in mid-July. To be sure, pension reform is supported in the Administration's FY 2000 Budget and in over 30 bills introduced so far in this session of Congress.

As part of a pension reform effort, there are several points that I would like to make at the outset:

- First, complexity in the employer-based pension system deters American workers from reaching their retirement goals and needs to be a major consideration for any legislative proposal. For example, subjecting proposals allowing "catch-up" contributions to complex non-discrimination testing rules will only undermine the desired intent of the proposals and prevent Americans from saving more for retirement.
- Second, existing limits surprisingly prevent even middle-class Americans from saving adequately for retirement and need to be increased. In addition, pockets of American workers need targeted additional "catch-up" relief from existing limits. They include women, those who have been out of the workforce, and "baby boomers" nearing retirement who have not had the opportunity to save adequately for retirement.
- Third, unnecessary regulatory barriers, and administrative costs and burdens are impediments to employers in establishing and promoting private pension plans, particularly small employers.
- Finally, many of the concerns just raised are addressed in legislation introduced this year by Members of this Committee, and others. I specifically refer to the "Retirement Savings Opportunity Act of 1999" (S. 646) recently introduced by Chairman Roth and Senator Baucus, and the "Pension Coverage and Portability Act" (S.741) introduced by Senators Graham and Grassley and co-sponsored by many other Members of this committee. The pension reform proposals in these bills address the overall goal of increasing retirement savings, while importantly reducing complexity, regulatory burdens and administrative costs.

We again encourage you to pass these proposals and make pension reform the "centerpiece" of the tax bill the Senate Finance Committee is expected to mark up in July.

The remainder of the testimony will provide additional discussion of the points raised above, starting with the issue of complexity.

I. COMPLEXITY

Let me start out with a straight-forward axiom. If taxpayers cannot understand our laws, regulations, and administrative rules — or if compliance with those requirements is prohibitively expensive — they will do one of three things. They will either: (1) engage in shortcuts; (2) not fully comply; or (3) not take advantage of the laws that are in place which are intended to benefit them.

While this axiom can be applied to all forms of tax law, it is particularly acute in the pension area. Private pension law has become increasingly more complex since ERISA was enacted many years ago. Today it is at a point where many feel the complexity related to the law overrides any underlying benefit. Congress has passed a significant number of changes in the pension laws over the years, with generally each change adding more complexity to the administration of the private pension system.

While the American public is becoming increasingly more aware of the vital nature of retirement savings, complexity in the law still acts as a deterrent to savings. If there is any complexity, uncertainty, or uneasiness in the way the laws work, taxpayers may simply not participate, as evidenced by the low participation rates today. This goes for employers not willing to establish or fully promote plans, as well as employees not feeling comfortable about participating in a plan that is available to them.

Statistics cited by Chairman Roth and Senator Baucus in introducing their bill point to the most recent Bureau of Labor Statistics figures which show that only 48 percent of employees in small business are likely to be covered by any retirement plan. Another study done in 1999 by the Spectrem Group, a retirement benefit research firm, shows that over 74 percent of companies with fewer than 100 employees do not offer any type of retirement plan. Some of the primary reasons cited by employers for not sponsoring plans are complexity and administrative costs. Regardless of the source of data and statistics, it is clear that the problem is huge.

Avoiding or reducing complexity needs to be a major goal both in considering new legislative proposals, and in reforming existing laws to better achieve desired objectives. Examples of how this goal can be achieved in both new proposals and changes to existing laws is set forth below.

A. Catch-up Provisions—Don't Subject to Complex Testing Rules

One of the most beneficial new legislative proposals being considered by Congress is a retirement savings proposal included in Chairman Roth's bill that allows participants who have reached the age of 50 to "catch-up" for lost time and contribute additional amounts to their retirement plans. Other types of "catch-up" proposals have been introduced on a bipartisan basis in both the House and the Senate. Some of these would require the "catch-up" to be subject to complex non-discrimination testing.

The NDCC wholeheartedly endorses the "catch-up" concept which benefits "baby boomers" who are now approaching retirement age and have not had the opportunity to save adequately for retirement, and who are now prevented from saving more because of existing limits. Typically, these individuals had other financial goals earlier in life such as paying school tuition, reducing home loans or taking time off to raise children. As they approach retirement age, they are more focused on reaching their retirement goals, but are prevented from doing so because of existing limits in the pension laws.

A recent industry survey by one of our member organizations of more than two million participants shows that over 37% of individuals who are prevented from saving more because of existing limits are age 50 or over. This percentage applies equally to both lower paid employees whose contributions are restricted by the section 415 limits, as well as others whose contributions are restricted by the section 402(g) limits or existing non-discrimination tests.

The objective of the legislative proposals is to allow these individuals to "catch-up" for lost time and allow them to put more money to work for retirement.

Importantly, this goal will be undermined if the proposals are subjected to complex non-discrimination tests. If the "catch-up" proposals are subject to non-discrimination testing, the employees who will be most disadvantaged are older, middle-class Americans. According to a recent industry study by one of our member organizations, nearly 40% of all employees age 50 who earn between $80,000 and $90,000 per year will not be able to save enough to retire at their present standard of living, even when combined with Social Security benefits.[1] Many of these individuals are part of an aging workforce who earned significantly smaller amounts early in their

[1] Based on an analysis of employees age 50 earning between $80,000 and $90,000 per year within a sample of more than two million participants. The analysis assumes the following:

All numbers are indexed for inflation at 3% per year;

Pre- and post-retirement rates of return are constant at 8%;

Social security is estimated to be $24,000 per year;

Amount required each year for retirement is 80% of final annual salary; and

Participant contributes the maximum dollar amount under section 402(g) each year, and receives a match equal to 50% of the first 6% of compensation.

careers and cannot now save enough for retirement given the constraints that the current contribution limits and non-discrimination tests have placed on them.

The "catch-up" proposals would aid these employees in reaching their retirement goals, but only if the proposals are not subject to the current complex non-discrimination tests. If these complex tests apply, many of the individuals who would otherwise be allowed to make "catch-up" contributions will be prevented from doing so. This occurs because of the unique way the current rules work for curing a failed non-discrimination test. In such a case, those individuals who would take advantage of the catch-up provisions would be the first to have their contributions returned as part of the curing process, making the catch-up provisions meaningless. The original intent of the "catch-up" proposals would, therefore, be frustrated where "one hand giveth, and the other taketh away."

Proposals subjecting the "catch-up" provisions to non-discrimination testing, would just add another layer of complexity to the private pension system and may themselves be unadministerable.

It is also important to recognize that retirement "catch-up" proposals already exist elsewhere in the tax Code, and that these existing provisions do not require non-discrimination testing. For example, section 403(b) plans and the provisions enacted as part of the Uniformed Services Employment and Reemployment Rights Act (the "USERRA" provisions for military personnel returning to the private sector) have "catch-up" provisions which are not subject to non-discrimination testing. These provisions also highlight the unequal savings opportunities for different Americans which exist because the laws with respect to retirement savings plans are not uniform.

Accordingly, the NDCC strongly supports the "catch-up" proposal included in the pension reform bill introduced by Chairman Roth and Senator Baucus, and would not support other "catch-up" proposals that require complex non-discrimination testing.

B. Ease Complexity—Pass Portability Provisions

Perhaps the best example of legislative proposals addressing complexity in current law are the proposals dealing with "portability," that is, the ability to take your pension assets with you as you change jobs. Americans change jobs on average about 7 or 8 times during their lives. Under current law, if you have a government job, like working for the Senate Finance Committee, and move to the private sector or to a tax-exempt organization, you simply cannot roll over your retirement money to the plan which may be sponsored by your new employer.

What typically happens is that an individual who changes jobs between the government, "for profit," or tax-exempt sectors starts participating in a plan offered by his/her new employer. As to his/her prior retirement savings, the choice is to either keep track of assets left with the old employer, roll the money into a "rollover IRA" which is subject to a whole different set of rules, or in the worst case scenario, cash out of the private pension system. Therefore, on one job change from the government to the private sector, an individual has to consider at least three different retirement plans (the government plan, the new employer's plan and a rollover IRA plan) and having done so, may be forced to continue with at least two of these plans. When as individual changes jobs more than once, the problem is compounded.

Americans do not need nor deserve this complexity. They need the ability and flexibility to be able to take their money with them when they change jobs and be able to do so in a simple, non-complex manner. Allowing "portability" would also lead to consolidation of retirement accounts, which leads to efficiencies and reductions in administrative costs to the individual participant. Since any existing account typically is subject to administrative fees, whether active or not, a consolidation of accounts will reduce costs. Portability also reduces "leakage" to the pension system by allowing an individual to consolidate his/her retirement savings, rather then "cashing-out" of the system.

The "portability" proposals introduced by Senators Graham and Grassley, and others, are extremely important because they address the problem of complexity by allowing individuals to take their retirement money with them as they change jobs. Moreover, the following additional features of the "Graham/Grassley" bill provide additional relief in the area of "portability:"

- Rollovers of "after-tax" contributions.
- Modification of the "same-desk" rule.
- Treatment of same distribution options.

The NDCC fully supports these "portability" proposals.

C. Other Proposals Addressing Complexity

The Graham/Grassley bill and other proposals in Congress would greatly reduce both administrative and legal complexities in other areas of pension law.

A great example is a proposal for uniform contribution limits among various plans, which the NDCC fully supports. Not only will this proposal reduce complexity in the private pension system, it will have the added benefit of providing a more equitable opportunity for Americans to save across the various plans that exist within the law today.

Other beneficial proposals include the following:

- Elimination of the 25% of compensation limit.
- Simplification of the non-discrimination tests.
- Repeal of the "multiple use" test.
- Uniform definition of "compensation" among pension plans.

The NDCC supports all of these proposals and encourages the committee to support making the pension system more equitable for all Americans as it simplifies the existing complexity of current pension law.

II. INCREASE EXISTING LIMITS AND PROVIDE TARGETED ASSISTANCE

Current law prevents many Americans from saving enough for retirement. One of the main deterrents is the existing limits which surprisingly prevents even middle-class Americans from saving adequately for retirement.

A. Increase Existing Limits

A recent analysis by Prudential makes this point dramatically. It shows that a middle-class individual earning $70,500 per year, who starts contributing the maximum allowable under current law to a 401(k) account at age 42, will exhaust all of his/her savings 6 years before his/her average life expectancy. This, unfortunately not-so-hypothetical individual, will then be forced to rely on other savings or government support for the remainder of his/her life. This analysis is attached as an exhibit hereto.

The Chairman's bill, as well as other legislative proposals, would address this problem by increasing current limitations to allow Americans to make additional contributions to their retirement savings plans. The proposals do so by increasing various income limits and contribution limits. These proposals all help those taxpayers who want to save more for retirement but who are prevented from doing so because of the limits of current law.

These contribution limits have not kept up with the retirement savings goals of Americans and need to be increased. The NDCC strongly supports proposals to increase these limits.

B. Provide Targeted Relief—Pass "Catch-up" Proposals

As mentioned above, Chairman Roth and others have introduced proposals which would allow Americans age 50 and older to increase the amount of contributions that can be contributed to salary reduction plans (e.g., 401(k) plans). These additional "catch-up" contributions allow taxpayers to make up for lost time and opportunities to save.

There are also other pockets of American workers who need targeted relief from existing limits. They include women and those who have been out of the workforce. Under current law, taxpayers who are unemployed or choose to be out of the workforce to raise a family generally cannot contribute to retirement savings accounts in a qualified plan. Moreover, when these individuals rejoin the workforce, there is no ability to "catch-up" for missed retirement savings contributions.

A proposal introduced last year in the House of Representatives by Congressman Weller and supported by the NDCC (H.R. 4123) would benefit women and others who have been out of the workforce by allowing anyone age 35 and older who has not been a participant under an employer-sponsored retirement plan for the past five calendar years to increase by $2,000 the amount that can be contributed to salary reduction plans until they reach the age of 50. Non-participation for the previous five years would be established by social security withholding records.

The NDCC supports these and other "catch-up" proposals, but only if they are not subject to the complex non-discrimination tests of current law.

III. UNNECESSARY REGULATORY BARRIERS AND ADMINISTRATIVE BURDENS

In addition to the complexity inherent in the underlying law mentioned earlier, there exists today an inordinate amount of unnecessary regulations and administrative burdens, all of which increase costs for employers and participants and reduce coverage.

These problems reduce the incentive for employers to establish and promote private pension plans and reduce the participation in plans by workers who choose not to avail themselves of existing savings opportunities. These problems are particularly acute for small employers. According to a recent survey by the Profit Sharing/401(k) Council of America, the three main reasons cited by employers for not offering a plan to their workers are: (1) the cost of administering the plan; (2) the cost of retaining experts to keep the plan in compliance with the laws; and (3) the complexity of the law which is so complex that they, as small business owners, don't have the time and knowledge to implement a plan.

The NDCC believes there are a number of unnecessary regulatory barriers and administrative burdens which should be removed from the private pension system. Fortunately, there are proposals pending in Congress which address these concerns. Among these helpful proposals are the following:

- Modification of the "Top Heavy" rules.
- Tax credit for start-up plans.
- Tax credit for contributions.
- Simplification or elimination of reporting requirements.
- Proposals to eliminate Red Tape (e.g., annual report dissemination proposal).
- Elimination of new plan fees.

The NDCC strongly supports these measures and would be happy to work with the committee on these and other proposals which reduce or eliminate unnecessary regulatory barriers and administrative burdens.

IV. PENDING LEGISLATION

The NDCC would like to go on record in support of passage of generally all provisions in the "Retirement Savings Opportunity Act of 1999" (S. 646) introduced by Chairman Roth and Senator Baucus, and the "Pension Coverage and Portability Act" (S.741) introduced by Senators Graham and Grassley and co-sponsored by many other Members of this committee.

Rather than picking and choosing from the items included in these bills, the NDCC supports passage of a well-reasoned package which contains these legislative proposals. If revenue is unavailable to pass all the proposals immediately, we would recommend generous phase-in rules for the more costly proposals.

V. CONCLUSION

In conclusion, we again urge the Committee to make pension reform the "centerpiece" of the tax bill you will soon be marking up. As you consider proposals in the pension area, we also urge you to do no harm. Please don't add additional complexity to the already burdensome private pension system, rather, focus on proposals that simplify the way Americans save for retirement and permit them to better achieve their retirement goals. As you move forward in this area, we also encourage you to provide more equitable opportunities for Americans to save across the existing private pension plan system.

Thank you again for this opportunity to testify today. We would be pleased to respond to any questions you or the Members of the Committee may have.

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Effects of Raising the Limitation on the Amount of Annual Elective Deferrals by Participants

PIIRS Market Research

Newark, New Jersey

April 14, 1999

Overview

The Tax Reform Act of 1986 placed a dollar limit on the amount of elective deferrals which were permitted to be made annually on behalf of an individual. This cap on elective deferrals was originally $7,000 and was to be indexed annually based on cost of living adjustments (i.e. inflation). With the cost of living increase, this amount was raised to $7,979 for 1990, $8,475 for 1991, $8,728 for 1992, $8,994 for 1993, $9,240 for 1994 and 1995, and $9,500 for 1996 and 1997. Currently, the cap is at $10,000.

Objective

The objective of this exercise was to determine whether or not 401(k) accounts together with social security entitlements are sufficient to replace 80% of a person's income; furthermore, we wanted to determine how changing the current deferral limit of $10,000 affects an individual's ability to achieve this percentage.

Method

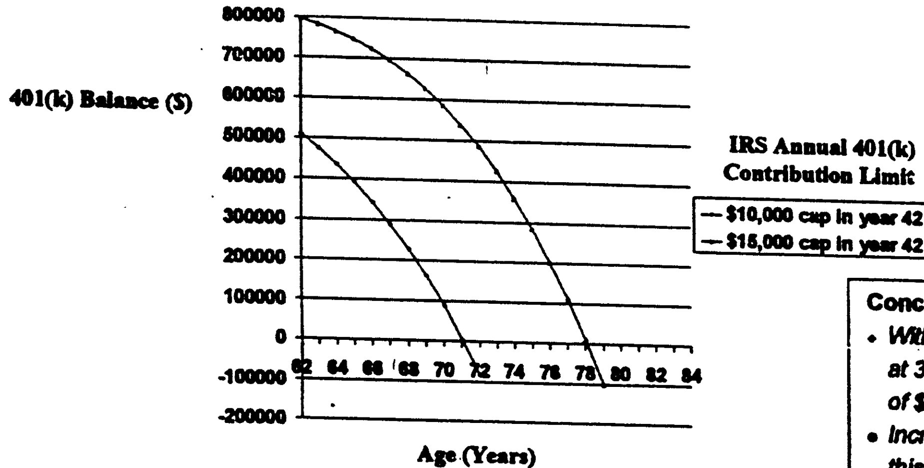
We created several models including individuals of various ages and salaries. The following model illustrates how the current deferral cap of $10,000 may be too low for certain individuals to save enough for a sustainable retirement. The model shows an an individual aged 42 earning $70,500/year.

The model assumes the individual has zero dollars saved in a 401(k) account, and the individual retires at the age of 62. The following chart shows the considerations and conclusions of this example. The social security entitlement used in the model is indexed annually to reflect the cost of living adjustment (3%). Also, the "normal" age of retirement is increasing and starting in the year 2000, social security benefits will reflect this shift. With this policy, individuals will receive full benefits according to the set "normal" retirement age for a particular year; retiring at an age before or after this age will be reflected as a percentage of their benefit (source: Employee Benefit Research Institute, 1998). For the purpose of this model, an individual retiring at age 62 in the year 2020, will receive 71.7% of his social security benefit.

Scenario: *Person Age 42, Retiring in the Year 2020*

Assumptions:

- *Person starts with a 401(k) balance of $0 at age 42, and maximizes his annual contribution*
- *Annual elective deferral ("cap") is indexed at 3% per year.*
- *401(k) balance compounds monthly at 0.569% (7.0% annually)*
- *Annual salary beginning at age 42 is $70,500 and increases annually at 3%*
- *Replacement ratio is 80% of highest salary, which is $123,622 at the end of age 61, in the year 2019*
- *Social security entitlement is $2,810 monthly (71.7% of social security entitlement in current dollars, in the year 2020)*
- *Average life expectancy for men and women in the U.S. is 78 years*
- *Person retires at age 62*



Conclusions:

- *With an IRS deferral limit starting at $10,000 at age 42 (and indexed at 3% yearly), this person will exhaust his accumulated 401(k) balance of $537,848 in the middle of year 71*
- *Increasing the limit to $15,000 (indexed at 3%) would allow this person to withdraw funds from his accumulated 401(k) balance of $806,772 through the end of year 78*

Prudential

COMMUNICATIONS

STATEMENT OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS

BULLETIN

July–August 1999

YOUR PENSION: IS IT LEAKING?

New-style plans give some people less

PAGE 3

BY HORACE B. DEETS

PENSION TROUBLE

Cash-balance switch can pose a threat

The Nation
NATIONAL NEWS OF INTEREST TO AARP MEMBERS

Is your pension leaking?

Long-tenured workers see losses from new cash-balance pensions

BY ROBERT LEWIS

Many corporations are ditching their traditional pensions for hybrid "cash-balance" plans, but the conversions often leave veteran employees with greatly reduced retirement benefits, critics say.

The controversial plans have

• COVER STORY

spawned lawsuits, age discrimination complaints and proposals in Congress to require companies to tell workers how much they might lose—or if they are younger, how much they might gain—when their pensions are switched.

What started as a trickle in the 1980s has turned into a torrent of cash-balance conversions—costing untold thousands of midcareer employees as much as one-half of their expected pensions.

Latest to make the switch is IBM, which installed a cash-balance plan July 1 for its 140,000 workers. IBM says the changeover will save $200 million a year. Fortunately for veteran employees, IBM will permit those within five years of retirement to stay in the older, more generous plan.

"Cash-balance pensions can be good for young, mobile workers," says Michele Varnhagen, policy director of the Pension Rights Center, based in Washington. "But they can deprive long-term employees in their 40s, 50s and 60s of retirement benefits they had counted on. We're pretty troubled by what's going on."

Companies can save money in cash-balance conversions in the way the formulas are restructured. By the same token, older workers can lose benefits because the formulas redirect money to younger employees.

The new plans combine features of traditional "defined-benefit" pensions with the popular 401(k) savings plans. Employers contribute a portion of pay, typically 4 percent or 5 percent, to hypothetical "accounts"

continued on page 20

Pensions

continued from page 3
that let workers track their balances. [See "As We See It," page 28.]

But the accounts are not the same as 401(k)s, which require contributions—and investment decisions—from employees. With hybrid plans, employers treat the accounts as a single pool of money and call the investment shots. These pensions are federally insured in case the employer goes bankrupt.

The most striking difference between the two types of pensions, however, is in how benefits are calculated. With cash-balance plans, the percentage of pay set aside for workers' pensions basically stays the same year after year.

With traditional pensions, accruals typically are lower at first and build up over time as an employee's wages rise. Since these pensions are usually based on the average of a worker's wages in the last few years on the job, plus years of service, older career employees come out much better.

"Just when you're getting to the most valuable part of the plan, it's not there anymore," says AARP lobbyist David Certner, pointing out the dilemma facing long-tenured workers shifted into cash-balance plans.

James Bruggeman, 50, of Tulsa, Okla., knows how this works. A senior engineering consultant with Central and South West Corp., Bruggeman says he lost more than 30 percent of his pension—some $400,000 expressed as a lump sum—when his firm switched to a cash-balance plan.

The Dallas-based electric utility grandfathered employees 50 and older with 10 years service into the old plan. Bruggeman has been with the company 24 years, but he missed the age cutoff by 14 months. Charging age discrimination, he filed a complaint with the U.S. Equal Employment Opportunity Commission.

Cash-balance conversions were concentrated originally in the banking and telecommunications industries.

Now the plans are spreading to other sectors, including such stalwarts as Aetna, CBS, Colgate-Palmolive, Cummins Engine, Eastman Kodak, Owens Corning, RJR Nabisco, Safeway, Times Mirror and Xerox.

Probably 500 plans covering 2 million to 3 million workers have made the switch, says Lawrence Sher of PricewaterhouseCoopers, a benefits consulting firm that has spearheaded the cash-balance movement.

Proponents of the new pensions say companies make the switch to attract the young, mobile worker who stays with one employer only a few years and then leaves with little or no pension accumulation. Departing workers with five or more years on the job can usually move their cash-balance pensions to an IRA or 401(k).

"We're changing because our employees are not interested in a pension that pays benefits at the end of a career," says Rita Metras, director of total compensation for Eastman Kodak. "They want to know what you're going to do for me now."

However, in its conversion, which takes effect Jan. 1, Kodak recognized that not all workers feel this way. It is giving employees of all ages the option of remaining in the old plan.

James Delaplane, vice president of retirement policy for the Association of Private Pension and Welfare Plans, which represents major corporations, says, "Individual accounts are easier to understand and are an added recruitment tool."

But Claude Poulin of Linden, Va., an actuary who represents employees, says it's clear companies make

Alert: Cash-balance plan disclosure

THE U.S. HOUSE AND SENATE tax committees are expected to consider pension legislation as part of tax bills later in July.

Now is the time to contact your senator and House member, at (202) 225-3121, and urge them to protect older workers in cash-balance plans. Urge them to require clear, individual statements to workers comparing any changes in plan benefits and to prevent any age discrimination.

the switch primarily to save money. And the idea that workers change jobs much more frequently than in the past is partly a myth, he adds.

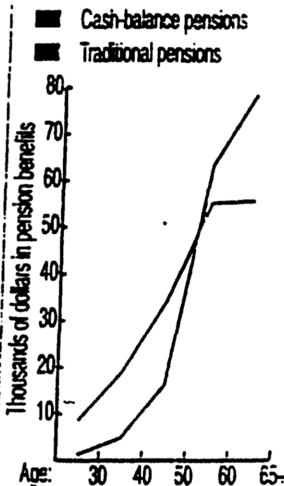
Studies by the U.S. Bureau of Labor Statistics show that median job tenure for men dropped only a little between 1963 and 1998—and actually rose for women. For example, median tenure for men age 45–54 fell to 9.4 years from 11.4 years in this period. But for women it rose to 7.2 years from 6.1 years.

Among several lawsuits challenging cash-balance conversions, one that is being closely watched is a class action case alleging age discrimination by the Onan Corp., a Minnesota subsidiary of Cummins Engine. Older workers charge that drastic pension cuts they incurred in the switch violated the Age Discrimination in Employment Act.

"It's the amazing disappearing pension," said Stephen Langlie, 65, a 37-year employee who saw his benefit plunge to $424 a month from the $1,100 he expected under the old plan. A lower court ruled against the workers, but with AARP Foundation Litigation as co-counsel, workers are appealing to the 8th Circuit Court of Appeals in St. Louis.

No law requires companies to offer pensions, and Congress is not likely to outlaw all cash-balance conversions. But there is support on Capitol Hill for a proposal by Sen. Daniel Patrick Moynihan, D-N.Y., and others to require plan sponsors to provide workers with detailed benefit estimates under the old and new plans. [See box on page 20.]

Cash-balance *vs.* traditional pensions: which does better?



Workers with traditional pensions earn higher benefits toward the end of their careers. Those in cash-balance plans earn benefits at an even rate through their working lives. As a result, younger workers actually come out ahead with cash-balance pensions. Older, longer-term workers fare better in traditional pensions.

This study is based on the average value of hypothetical pensions earned by 250,000 employees enrolled in 35 large pension plans who retired or left their jobs between 1983 and 1996.

Source: Society of Actuaries, Oct. 1998.

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AS WE SEE IT

Horace B. Deets, AARP Executive Director

Cash-balance pensions: Scrambling the nest egg

Yogi Berra's prediction that "the future ain't what it used to be" is coming true for many midlife and older workers whose traditional defined-benefit pension plans are being converted to cash-balance pension plans by their employers. [See article on page 3.] Under the traditional plans, employees earn the bulk of their benefits during their last few years when their earnings tend to be highest and their number of years in the plan are greatest. Under the cash-balance pension plans, benefits accrue at a flatter rate throughout one's career, thus are of greater benefit to younger workers. Moreover, they are portable, so employees can take them from job to job. This makes them popular with younger workers who may not stay with one employer for a long enough time to reap larger benefits.

Cash-balance pensions also are becoming increasingly popular with employers because they tend to be less costly, help attract younger workers and limit the incentive for workers to stay on the job longer just to build their pensions. Also, cash-balance pensions are similar to defined-contribution plans like 401(k) plans in that they involve individual accounts that enable workers to see more clearly the benefits they're accruing.

Cash-balance pensions, however, are not such a good deal for midlife and older workers. Their accounts have less time to grow, and they are likely to lose substantial benefits when an employer changes from a defined-benefit plan to a cash-balance plan. Workers in their 40s and 50s could see a 30 percent to 50 percent reduction in their final benefits. And it could be even worse for some older workers.

Another problem centers around information about the conversion process. Just when a seasoned employee is about to get to the most valuable part of the pension plan, it's all changed, and he or she does not have a clue what happened to his or her nest egg, only that it is not what it should be. It is as though the employer scrambled the employee's nest egg, and when they put it back together, it was smaller.

Sen. Daniel Patrick Moynihan, D-N.Y., and Rep. Jerry Weller, R-Ill., have introduced companion bills that would require employers to provide employees with an individual statement comparing their projected benefits in their old plans and the new cash-balance plans. This disclosure is important, but employees also need to take it upon themselves to know how their pension plan works and what types of plans their employer offers.

As we have said many times, pensions must be viewed as part of the whole retirement package along with personal savings, investments and Social Security, because they all work together to build your retirement nest egg. By converting defined-benefit pensions into cash-balance pensions, employers are putting added stress on Social Security and personal savings, particularly for older workers. At a time when people are living longer and saving less, and the long-term solvency of Social Security is not yet resolved, now is not the time to change the rules on midlife and older workers.

NEWS RELEASE

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ACLI ENDORSES BILLS TO BOOST AMERICANS' RETIREMENT SECURITY

Washington, D.C. (June 29, 1999) – The American Council of Life Insurance (ACLI) today endorsed two bills designed to boost Americans' financial security in retirement. Both would build on the foundations of the nation's successful private retirement system, which is based on employer-sponsored pensions and private retirement savings plans.

"With additional incentives, simplification and expansion, employer-based retirement plans and personal savings will increase retirement security in terms of both the number of individuals covered and the amount of retirement income they receive," Ann Combs, ACLI's Vice President for Retirement and Pension Issues, testified at a Senate Finance Committee hearing.

Specifically, Combs endorsed the Retirement Savings Opportunity Act of 1999 (S. 646), sponsored by Finance Committee Chairman William Roth (R-DE) and Sen. Max Baucus (D-MT) and the Pension Coverage and Portability Act (S. 741), sponsored by Sen. Charles Grassley (R-IA) and Sen. Bob Graham, (D-FL). Both bills would help Americans save more for retirement in both private savings plans and employer-sponsored retirement plans.

"These two pieces of legislation are being considered at a critical time," Combs said. "With the aging of the Baby Boom cohort, coupled with the uncertain future of government entitlement programs, including Social Security and Medicare, it is critical that voluntary employer-sponsored plans and individual savings be strengthened to meet the retirement security challenges of the 21st century."

Evidence is mounting that building on the current employer-sponsored retirement system offers the best route for helping Americans achieve retirement security. Recent Census Bureau data shows that middle-income Americans are major beneficiaries of employer-based retirement plans -- contrary to the popular belief that pensions primarily benefit the wealthy.

According to U.S. Census Bureau data for 1997:

- 77 percent of pension plan participants have annual earnings below $50,000;
- Among married couples, 70 percent of pension recipients had incomes below $50,000;
- Among widows and widowers, 55 percent of pension recipients had incomes below $25,000;
- Over 50 percent of pension benefits are paid to elderly with adjusted gross incomes below $30,000.

(MORE)

PREPARED STATEMENT OF AMR CORPORATION

INTRODUCTION AND OVERVIEW

Employer-sponsored defined benefit retirement plans play an integral role in guaranteeing retirement security. Yet arbitrary and onerous regulations can encourage certain employers to abandon such plans. This testimony outlines the comments of AMR Corporation on one aspect of how the Internal Revenue Code of 1986 (the "Code"), as amended, has been interpreted to impose unfair rules on the sponsors of defined benefit retirement plans permitting lump sum payments for retiring employees.

Under the Code, "qualified" pension plans must offer a lifetime stream of monthly payments to plan participants, commencing upon retirement. Many pension plans permit participants to receive the value of this lifetime income stream in a single lump sum payment. In determining the "present value" of the lifetime income stream that is being cashed out, the period over which payments are expected to be made (the period ending with the assumed date of death) and the rate at which funds are expected to grow (the assumed interest rate) are necessary assumptions. The interest rate and mortality assumptions are therefore critical in calculating the lump sum value of lifetime benefits.

The Retirement Protection Act of 1994 (the "RPA") amended section 417(e) of the Internal Revenue Code to specify an interest rate that must be used to convert a pension to a single lump sum. The RPA also authorizes the Secretary of the Treasury to prescribe a mortality table for use in calculating lump sums under section 417(e) of the Code. We perceive no problem with the current statutory language itself, only with its implementation by the Internal Revenue Service.

The Internal Revenue Service has prescribed a mortality table for use by retirement plans. We have no objection to the table itself. However, we are concerned with the requirement that the table is to be used together with the mandatory assumption that half of the participants covered by the plan are male and half are female.

The requirement that a plan must assume that half its participants are male and half are female is highly questionable. The participation in many plans is dominated by one gender. It is an accepted scientific fact that females, as a class, have a longer life expectancy than males, as a class. Prescribing an artificial "gender mix," therefore, artificially and inaccurately enlarges or contracts the true average life expectancy of the work force covered by the pension plan unless the plan's gender mix is actually in balance. Assumed life expectancy is a major factor in calculating the amount of a lump sum distribution and in funding plans, regardless of whether a lump sum distribution benefit is offered.

These regulations, which appear at Treas. Reg. Section 1.417(e)-1(d)(2) (the regulations) (effective April 3, 1998), do twist actuarial reality by arbitrarily imposing a mandatory gender neutral mortality table on pension plans that permit lump sum payments. A directly relevant revenue ruling, Rev. Rul. 95-6, 1995-1 C.B. 80, 95 TNT 2-1, contains provisions that operate in tandem with the regulations. Under these rules, regardless of whether the participants in a qualified defined benefit pension plan are 90 percent female or 1 percent female, all lump sum payments must be calculated using a mortality table that assumes the plan population is 50 percent female and 50 percent male. The IRS has essentially imposed a requirement that a pension plan comprised almost entirely of men must pretend that half its covered participants are women when it calculates its pension payments. These regulations give employers of work forces that are gender-imbalanced one more reason to abandon their defined benefit plans, or not to adopt them. We anticipate that this issue will raise more concern when companies with such plans realize that by 2000 all their lump sum distributions will have to be calculated based on this arbitrary gender assumption.

The legislative history accompanying the 1993 law mandating that Treasury create appropriate mortality tables gives no indication whatsoever that Treasury should issue such an arbitrary rule. If Treasury and the IRS are unwilling to change their rules to reflect actuarial reality, we hope that Congress will amend this law to mandate that Treasury utilize gender factors reflecting reality in those benefit plans where participant gender ratios are particularly unbalanced.

THE PROBLEM

A lump sum distribution from a qualified defined benefit pension plan to a participant is designed to be the "actuarial equivalent" of the payments that would otherwise be made during that participant's lifetime following retirement (or over the joint lifetime of the participant and the participant's spouse or other designated an-

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nuitant). To fund this lifetime income, a plan can use assumptions based on the expected lifetimes of its participants and can recognize, for example, that the covered participant population is 80 percent female and 20 percent male. The assumed mortality rates of participants is obviously a major factor in funding pension benefits, and it is a universally-accepted and well-documented fact that females will on average out-live males of the same age.

In contrast, if lifetime benefits are paid out in a lump sum, actuarial reality as described above for funding plans is ignored under current Internal Revenue Service rules. To determine the amount of lump sum payments, the regulations and Rev. Rul. 95-6 require plans to use a mortality table that assumes half the covered participant population is male and half is female. In the example given above (80 percent female and 20 percent male), the mandated 50/50 assumption artificially shortens the expected lifetimes of plan participants who are female, at least in comparison with the actual gender factors that can be used in the plan's funding. Nothing in the statute, which simply requires a "realistic" mortality table without reference to gender, mandates this arbitrary result.

Looking at this result from another perspective, the greater the gender disparity in favor of males, the more likely the plan will be underfunded if benefits are regularly paid in the form of a lump sum. Conversely, the greater the disparity in favor of females, the more the plan will become overfunded because expected lifetimes are artificially reduced.

CURRENT LAW

The Retirement Protection Act of 1994, enacted as part of the General Agreement on Trade and Tariffs, amended section 417(e) of the Code, as well as other sections of the Code and the Employee Retirement Income Security Act of 1974, as amended. GATT made two significant changes affecting the calculation of minimum lump sum payments. First, the statute redefined the applicable interest rate. Second, the legislation authorized the Treasury Secretary to prescribe a mortality table for use in calculating the present value of qualified plan benefits. Nothing in the legislative history of GATT indicates that Congress intended to preset a particular gender blend version of GAM 83.

Less than two months after passage of GATT, the Internal Revenue Service quickly published a mortality table in Rev. Rul. 95-6 for use under section 417(e). As provided in the statute, the Service's table uses the current prevailing commissioner's standard table for group annuities, or the 1983 GAM Table, which is a sex-distinct table (GAM 83). However, the ruling requires a 50/50 mandatory gender split assumption.

As mentioned above, the Secretary issued final regulations on both the new interest rate mortality table assumptions, in April of 1998. The regulations provide specific guidance on how the interest rate provisions are to be implemented. In contrast, for the applicable mortality table, the regulations provide only that the table is to be "prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin." Treas. Reg. Section 1.417(e)-I(d)(2). Treasury's approach of publishing the table required by the statute in a revenue ruling, instead of in the regulations, effectively precluded needed public comment on the 50/50 mandatory gender split that would have otherwise been required under the Administrative Procedures Act.

The adverse impact of the regulations will be felt particularly in industries where plans are collectively bargained. These plans, presumably for historical reasons, cover work forces that are frequently heavily skewed by gender. Collectively bargained workforces that are dominated by females include flight attendants and skilled nurses. Conversely, such workforces dominated by males consist of, for example, heavy construction, road building, pilots, long-haul trucking, movers of household goods, oil and gas, mining, and forestry workers. Accordingly, this arbitrary regulatory fiat will work to overfund pensions in industries where rates of female plan participation are particularly high and will work to underfund pensions where rates of male participation are high.

Rev. Rul. 95-6 hardly levels the playing field between annuities and lump sums. Male employees in male-dominated plan populations will be strongly encouraged to take their benefits in a lump sum in order to take advantage of the windfall, possibly exposing their retirement security to the increased risk of dissipation of their retirement "nest egg." Female employees in female dominated plans will receive less than they would if the plan assumptions reflected reality of workforce participation by gender.

EFFECT OF A 50/50 MORTALITY TABLE

The Service's 50/50-gender blend table has an unintended and inequitable effect on the level of funding and on the calculation of the present value of lump sum payments. As previously discussed, the primary focus of GATT was on reducing underfunding of pension plans. Accordingly, GATT's applicable mortality table was designed to prevent plan sponsors from making assumptions that placed plans at risk by minimized funding obligations. The 50/50 mortality table assumptions negate that goal by reducing a plan's ability to provide an accurate and adequate funding level. The 50/50 assumption, which can be objectively inaccurate, requires plan administrators to calculate actuarially inaccurate present values of lump sum payments, at least where plan population by gender is unbalanced.

For example, if an individual would receive a $1,000 lump sum payment at retirement based on GAM 83 using gender specific mortality, the following table presents the adjusted lump sum amount that would be paid to that individual using the 50/50 blended table:

EFFECT OF BLENDED MORTALITY TABLE ON GENDER SPECIFIC—LUMP SUM OF $1,000

(Discount Rate: 7.0 percent)

Age	Male	Female
55	$1,042	$955
60	$1,053	$944
65	$1,068	$929

This table shows that an age 60 male retiree receives a $53 windfall under the 50/50-blended table and an age 60 female retiree receives a $56 shortfall.

PROPOSED AMENDMENT

Congress should rectify this inaccurate treatment by amending the Code to include a rule addressing use of the required mortality table for those plans which contain a lump sum distribution option and which cover populations that are primarily male or primarily female. For example, the Code could be amended to include a proposal that would provide an alternative rule for determining the present value of a permitted lump sum payment if 80 percent or more of a plan's covered participant population is comprised of a single gender. In such cases, the plan would be permitted an election to utilize Treasury's applicable mortality table with the assumption that the dominant gender comprises 80 percent, and the minority gender comprises 20 percent, of the plan's covered participant population. In order to keep the proposal simple, the rule could provide that, if in any subsequent plan year the plan did not satisfy the 80 percent test then, in that and all successive plan years, the plan sponsor could not make such an election.

STATEMENT OF ANONYMOUS #1

Learned Senators of The Senate Health, Education, Labor and Pension Committee and The Senate Finance Committee:

I am writing to express my opposition to the current version of the Employee Retirement Income Security Act (ERISA) that allows employers to force employees to accept changes in benefit plans. Because of the current state of ERISA, some of the most respected corporations in this country are beginning the disturbing trend of disenfranchising large percentages of their work force from long promised pension and medical benefits without regard to norms of contract or tort law, fiduciary obligations, age discrimination, or any ethical norms of business conduct. This trend is done under the guise of converting so called "defined benefit plans" to "cash balance plans."

Senator Harkin and Senator Moynihan have both proposed bills to address these issues and these bills should be supported. However, even stronger and immediate measures should be taken to protect employees, and indeed, the economic future of our country.

Since the current laws offer employees little protection in the area of pension and medical plan conversion, employers are reducing benefits for a large number of their employees at an alarming rate. The employees suffering the greatest loss under these conversions are "mid career" employees, i.e., the "baby boomers." The boomers are loosing large portions of promised and earned retirement and medical benefits

at a time in their careers that makes it most difficult to recover from these losses. These employees, typically the ones that loyally stood by their corporations in the early, troubled 1990's, during low corporate earnings and down sizing, are now loosing needed future retirement income and/or are being force to work longer for the same benefits in a time of record corporate earnings and extravagant executive compensation. When these boomers retire in the next 5-25 years, the largest segment of our country's population will have a short fall of retirement income. This short fall will have to be made up by the government (higher taxes) or reduced spending by the retirees. In either case, there will be profound detrimental effects on our economy.

The changes to ERISA needed are not meant to give anyone a "handout" or to over burden industry. Over the course of decades, these employers have promised employees these benefits, and in fact consistently made good on their promises. Employers have known for years what funding these pension plans required and currently most of the funds are very well funded. As clearly demonstrated by present technology, employer sophistication on these complex issues, and employer record earnings, employers are very well capable of meeting their obligations.

Employees have relied on the fact that these benefits would be available to them when they reached retirement eligibility. Over the years, companies made many representations, both written and oral, to employees that their compensation was competitive if the employee considered the "entire compensation package" offered—the salary, pension, medical, and other benefits. During much of this time employers honored these commitments for people that retired. In many cases employees turned down other employers who offered higher salaries or did not choose other promising career paths because employees believed they would "lock in" pension and medical benefits if they remained with the company. In many cases, these employees have loyally remained with these employers for 10, 20, or more years largely in reliance on these promises. However, now employees are finding that not only is this reliance misplaced, but that the law allows employers to unilaterally and arbitrarily decide to not provide any benefit that is not "accrued." Arguably under ERISA, the employer can decide not to fulfill his part of the bargain despite what was promised and understood between the parties without regard to any liability under contract law!

Further, there seems to be no law preventing employers from withholding information critically needed to evaluate the impact of these forced changes on the financial future of employees. ERISA does not seem to prevent employers from providing the affected employees with deceptive and misleading information about these changes. Without a strong background in finance, accounting, and/or mathematics and access to relevant information, it is nearly impossible to determine the real effect of these forced changes on the financial future of employees. It is fair to say that most of the employees affected by these forced changes do not understand the changes or the actions required to protect their financial future.

But the employers certainly do understand. Conversions to cash balance plans typically are rolled out with military like precision. All the legalities are carefully researched and employees are provided with "glossy marketing materials" claiming how the new cash balance plans are portable and make the company more competitive. The employer doesn't tell the employee that this portability just reduced that value of pension and medical benefits by 30 to 50%. Deception and misrepresentation are easily found in many of these conversions. But this seems to be permissible under ERISA!

Sometimes these plans are run by the employer. This should put the employer, as trustee of the plan, in a fiduciary relationship with the employee, the plan beneficiary. Therefore, the employer should have a strict duty to look out for the interests of the employee. Often this is not what happens. Employers have solicited actuaries for ways to: gain access to the cash in the plan, stop funding the plans at accelerate rates when employees get older, and use plan funds for other employee benefits. (Some of these employee benefits are lucrative stock options for select, over compensated executives.) These activities would be actionable under long established law governing trusts. However, ERISA not only seems to allow these employer activities but under ERISA employers think they do not have to look out for the employee (beneficiary) interests or even disclose these activities in a forthright way!

What is permitted under ERISA does not seem consistent with other federal law. One of the stated advantages of these conversions is that the company will become more competitive because money saved by the conversion can be used to give better offers to potential new hires. The employer is really saying that money promised to fund medical and pension plans at the required accelerated rate for employees nearing retirement age will now be used to hire more inexpensive, i.e., younger, em-

ployees. Thus, there is a transfer of money promised to and expected by older employees to younger employees. The older employees now have reduced pension and medical benefits, or at best have to work years longer for the same benefits (so called "wear away"), while younger employees receive improved starting incentives. Anyone familiar with these conversions can see this is age discrimination of the most blatant form, however, ERISA seems to encourage this!

ERISA in its current form is a threat to our country's financial future. What will the economic landscape of America be in 5-25 years when the "baby boom" generation starts retiring and realizes they have much less than their expected pension and medical benefits? Who will bear the expense of supporting this large demographic of future elderly when they have inadequate pension/medical benefits? Won't their more limited disposable income slow down our economic growth? Will they be forced to prematurely cash in their investments and won't that put downward pressure on the stock market? How can our medical facilities support an aging population's medical needs if there is less available retiree money to pay for these facilities? Will the government be forced to raise taxes on our children to support retirees who have been cheated out of their promised and earned benefits? Why should our laws permit short sighted and greedy corporate executives to place our country in this situation by pilfering retirement and medical plans that they should be obligated to protect?

It is truly disturbing that ERISA, a statute that was implemented to protect employees, has turned into a vehicle that permits employers for years to mislead employees with promises, a corporate culture, and a course of action and then arbitrarily reduce benefits without being accountable to employees under any theory of contract or tort law that has developed and governed business dealings for centuries. Shouldn't the workplace be governed by these norms of conduct and not some cheap "bait and switch" scheme used by common scam artists?

I implore you to reexamine the provisions of ERISA and other legislation concerning employee pension and medical benefits and make the necessary changes to protect employees. Senator Moynihan's bill S. 659 and Senator Harkin's bill S. 1300 are a good start and I urge that you support them. However, the law protecting employees needs to go further than disclosure of the effects of plan changes. Congress should put an immediate moratorium on these conversions until their effects are truly understood. Employers need to be bound by promises they make to their employees, expressed or implied, and should not be able to provide deceptive and misleading information to their employees. Employers changing pension and medical plan should have to give employees a choice to remain in any pension plan in which that they vest (after 5 years). Employers should be prevented from forcing any plan conversions upon vested employees. Further, any provision in ERISA that preempts state contract and tort law should be removed and employers should be subject to punitive damages for misrepresentations made to their employees and breaches of fiduciary relationships. These changes should be made retroactive to protect employees that have already experienced the harsh reality of a conversion to a cash balance plan.

I regrettably choose to keep my identity confidential because I no longer trust that my employer will treat me fairly if my opinion on these matters is made public and do not think I would be adequately protected by law. Unfortunately, trust in the workplace is another thing that has been severely damaged by the actions that ERISA permits employers to do. I sincerely hope that the employees of America can count on you, good senators, to restore our pension rights and our trust in the workplace. Thank you for your time and future support on these issues.

STATEMENT OF ANONYMOUS #2

As a person adversely affected by a defined benefit/cash balance pension (DB/CB) conversion I am submitting this statement for inclusion in the hearing record. I am not identifying myself since I have a concern that my employer would retaliate against me for submitting this statement.

Pensions are covered by Employees Retirement Income Security Act (ERISA). The title is paradoxical since it implies that this statute provides "security" for retirement benefits for "employees." The protection, however, appears to be very insubstantial, since DB/CB pension conversions substantially reduce benefits. Traditional defined benefit pensions and other retirement benefits (such as medical benefits) were in part offered by employers as a means for retaining employees. The value of a defined benefit pension is substantially greater if an employee remains with one employer for an entire career.

I have worked for a significant number of years for the same employer who repeatedly referred to the retirement medical benefits and pension as part of my compensation. They were to be considered when evaluating compensation offered by other potential employers. My employer has now significantly reduced the value of the retirement medical benefits and pension benefits. My employer has provided computer systems to estimate my future pension. This permitted me to determine whether I wanted to save additional money for retirement. My employer's DB/CB conversion has completely destroyed my plan. ERISA apparently does not obligate my employer to provide the retirement benefits they said would be there for me as an inducement for me to remain employed with them? Since I did not act on offers for higher paying jobs based on my employers retirement benefits, I relied to my detriment since my employer is substantially reducing these benefits. Why does ERISA and why is Congress permitting this to happen?

Many people adversely affected by DB/CB conversions do not know how to calculate the amount by which their benefits will be reduced. ERISA does not appears to require an employer to clearly inform employees of the degree of benefit change. Not only is my employer not clearly informing employees, but is presenting the new cash balance plan in a manner that leaves the impression that the cash balance plan is "better." Unfortunately, many employees believe this. They essentially base their judgment on observing others who have successfully retired on the company's previous pension and medical benefits. Notwithstanding that my employer has provided a new computer system to calculate the new pension (which can only be considered as speculative since it apparently can be completely dropped under ERISA), they have withdrawn the system to calculate the benefit under the old defined benefit pension plan. Thus a direct comparison cannot be made.

My pension under the cash balance plan is as much as 50 % less than under the defined benefit plan. This results for two reasons: a reduction in value of the already accrued benefit to about ‡ the value under the old defined benefit plan and contributing about ‡ the amount of money to my pension plan for future years. This essentially cuts out the rise in pension value which occurs in the latter years of employment. My already accrued benefit is reduced to ‡ the value under the defined benefit plan since my employer is treating me as though I have terminated employment.

I support Senator Moynihan's bill S659 and Senator Harkin's bill S1300. An employer should not be able to reduce benefits (pension and retirement medical benefits) which were used to induce an employee to remain with the employer. If ERISA permits this, ERISA should be changed to prohibit it.

United States Committee on Finance
Hearing on Cash Balance Pension Plans and Other Pension Issues
June 30, 1999

Chairman Roth, Ranking Member Senator Moynihan, and members of the committee. Thank you for including my written testimony in the hearing record for today's hearing.

My name is Gerard T. Benson and I am a 25-year employee of I B M. In July of 1999 I B M will convert from it's traditional defined benefit pension plan to a "cash balance" pension plan. In June I B M sent a booklet to all employees with a detailed description of each persons dollar value of their pension. As a result of this conversion, I will lose approximately 30% to 45% of the value of my pension, which will translate into a dollar loss of approximately $75,0000 to $100,000 by age 55. I am able to provide only approximate calculations because my employer will not provide me with more specific information regarding the difference between the old plan and the cash balance plan. This is after a previous change in the pension plan just 4 years ago, which limited the growth of my pension. Now they are taking that limit, that I thought was protected by law, and taking almost half of it away and converting it into bottom line credits to make the profit numbers look good so the senior executives can take more stock options.

As you can see, this is a very serious loss for me. I have made some financial plans that included my pension dollars and now those plans are shot. I will have to work an additional 5 or 6 years to get those stolen dollars back. This will also significantly effect my children's educational plans.

While I am loosing these dollars, I B M has announced it will save $200 Million from this pension change, but the more reading I do, some people feel the number could reach $600 Million. Moreover Mr. Lou Gerstner, CEO, executed his stock options recently to the tune of $34 Million. With $600 Million in pre-tax credits I'm sure the "bottom line" will look great and the bonuses and stock options all the senior executives have, it will be more millions in their pockets. This is nothing more than corporate "rape". I know a corporation as large as I B M could not get away with doing anything that was illegal in this matter but that is the case in point. Current law allows companies to make changes to employee pension plan without even disclosing the actual benefit cuts. Congress MUST CHANGE THIS!!! It is outrageous how these calloused executives can take back money retroactive to an employee's date of hire. All those years of I B M providing me an annual package that stated, if I continued to work hard and performed to satisfaction, that this value would be there for me when I retired. Guess what, they lied. I can't begin to express my disbelief of how unfair this is but also how unethical an act this is. Employees deserve to know how they are being affected. I urge the committee to act quickly and favorably on Senator Moynihan's bill, the Pension Right to Know Act(s. 659)

Thank you very much,

United States Committee on Finance
Hearing on Cash Balance Pension Plans and Other Pension Issues
June 30, 1999

Chairman Roth, Ranking Member Senator Moynihan, and members of the Committee. Thank you for including my written testimony in the hearing record for today's hearing.

My name is James A. Bruggeman. I am a 27-year employee of Central and South West Corporation (CSW) from Tulsa, Oklahoma. In July 1997, my company converted from its traditional defined benefit pension plan to a "cash balance" pension plan. As a result, I will lose approximately 30% of the value of my pension, which translates into a dollar loss well in excess of $400,000. It took several months of my personal time to gather information and to prepare spreadsheets to make this loss calculation because my employer has refused to provide me with comparisons of my benefits under the old and new plans. My employer has also refused to provide computer software that would allow its employees to make these calculations. Fortunately, I have a background in probabilities and statistics and present value comparisons through my formal education, work experience and hobbies. Without this background, I would have been unable to make the calculations.

For me this is a very serious loss. It may very well change my retirement plans. I would have to work several more years to make up the loss.

My company announced in August 1997 that it saved $20 million in 1997 due to the new plan. And the new pension plan was in effect only six months of 1997. The company also stated that it expected to realize significant ongoing reductions in operating and maintenance expense because of the change. In December 1996, CSW entered into "Change of Control Agreements" with 16 key executives. CSW later reported that these agreements will require it to pay the 16 executives $69 million on closing of a contemplated merger between CSW and American Electric Power Company. Healthy bonuses were provided to CSW executives in both 1997 and 1998.

Current law allows companies to make these changes to employee pension plans without even disclosing the actual benefit cuts. This is outrageous. My employer's communications to it employees went so far as to lead employees into believing that their benefits were not being reduced. Congress must change the law to require employers to disclose the amount of the benefit reductions. Employees deserve to know how they are being affected. I urge the Committee to act quickly and favorably on Senator Moynihan's bill, the Pension Right to Know Act (S. 659).

Sincerely,

James A. Bruggeman

Testimony for Senate Committee on Finance
Hearing on Pension Reform Legislation

Provided by:
Certified Financial Planner Board of Standards

The Certified Financial Planner Board of Standards, Inc. is submitting this testimony to the United States Senate Committee on Finance for inclusion in the written record of the Committee's June 30, 1999 hearing on Pension Reform Legislation.

The Certified Financial Planner Board of Standards, Inc., known as the CFP Board, is pleased to provide information concerning Americans' financial futures for the Committee. The CFP Board is the professional regulatory organization for over 34,000 CFP marks holders or licensees. The CFP Board was formed in 1985 to benefit the public by fostering professional standards in personal financial planning.

The CFP Board wants the Committee to be aware of a very serious problem in this country. Americans are not saving nearly enough for retirement. They are not investing properly, most of them do not have any kind of financial plan for their retirement years, they do not understand the differences between managing money before and after retirement, and they are very uncomfortable with making the plans for their financial futures. So far, the solutions Congress has created have not addressed the situation.

One can not read a paper or magazine, hear the radio, or watch the television news without seeing something about the retirement crisis facing this country. A 1997 Consumer Federation of American and NationsBank survey found only one in three savers has a comprehensive retirement plan. In many ways, it is fair to say financially, this is a nation at risk. Many Americans are finally starting to realize their future is in their own hands. In a self-directed, defined contribution plan world, they need to be able to properly plan for their financial futures since government sources are not nearly going to cover all of our expenses in retirement.

The CFP Board's September 1998 testimony before the Department of Labor's ERISA Advisory Council Working Group on Small Business provided the results of a 1998 survey of CFP marks licensees. The survey revealed 67% of CFP licensees' prospective clients consider their employer's retirement plans as their primary source for funding retirement goals. However, CFP licensees report only a quarter of their prospective clients are contributing the maximum amount to their pension plans. These figures are even more disturbing when we realize that those seeking financial planning advice are more aware of the need for retirement than the general population.

The state of Americans' financial planning is not surprising. Over the past 20 years, this country has undertaken a massive transfer of financial responsibility from professional pension plan managers to everyday workers. Retirement planning has moved away from the old defined benefit pension plans that required absolutely no input from participants, provided a

guaranteed monthly income for life and were managed by highly trained professionals. Now, those plans are largely a variety of self-directed defined contribution plans, such as the 401(k), that require participants to manage their own accounts. Essentially, American workers have become their own pension plan managers.

The problem is that very few American workers have ever had any education or training in retirement or financial planning. Securities and Exchange Commission Chairman Arthur Levitt in an April 1999 speech stated, "The plain truth is that we are in the midst of a financial literacy crisis. Too many people don't know how to determine saving and investment objectives or their tolerance for risk. Too many people don't know how to choose an investment, or an investment professional, or where to turn for help."

As an educational resource to the American Institute of Certified Public Accountant's (AICPA) Retirement Security through Financial Planning Coalition, the CFP Board strongly believes the retirement education proposals contained in Section 503 of S. 741 (Graham-Grassley) will encourage American workers to plan and save for their financial futures. However, a greater service could be done for American workers if the provisions went beyond simply retirement and included financial planning.

Financial planning is the process of meeting life goals through the proper management of personal finances. Life goals can include buying a home, funding a child's education, passing along a family business, or planning for the years after retirement. Financial planning provides direction and meaning for financial decisions. It allows one to understand how each financial decision affects other areas of personal finances. For example, buying a particular investment product might help pay off a mortgage faster, or it may delay retirement significantly. By reviewing each financial decision as part of a whole, one can consider short and long-term effects on life goals. One can also adapt more easily to life changes and feel more secure about reaching life goals.

In their 1997 9th Annual Retirement Planning Survey, Merrill Lynch, Inc. found people with financial plans feel more confident about their investment skills and ability to achieve their financial goals. Those with a written plan prepared by a professional are most confident. Half of people who have professionally prepared financial plans and 44% of those with self-prepared plans are "very confident" they will realize their financial goals. Less than a third of the people with no plans feel this confident, and 20% are not very or not at all confident they will realize their goals. People who have financial plans are significantly more likely to have a written budget and to put money into savings before paying other expenses (41% of planners put money in savings first then pay bills while only 14% of people who have no plans did). These figures demonstrate the urgent need for Americans to have the opportunities and incentives to develop plans for their financial futures.

The CFP Board believes if the proposals contained in section 520 of H.R. 1102 and Section 503 of S. 741 become law, the nation will be making an investment in the retirement security of the American worker. These two proposals are a step though in achieving retirement security through financial planning. There are many other steps and reaching them all will require commitment. As Peter Druker said,

"Unless commitment is made, there are only promises and hopes... but no plans."

If Congress wants to help Americans reach their financial goals and not simply make promises to them and raise their hopes, it must commit to helping them plan for the future.

STATEMENT OF THE FINANCIAL PLANNING COALITION

[SUBMITTED BY PETER M. KRAVITZ, DIRECTOR, CONGRESSIONAL AND POLITICAL AFFAIRS, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTS]

This Statement is being submitted to the Committee on Finance of the United States Senate by the Financial Planning Coalition for inclusion in the written record of the June 30, 1999, hearing before the Committee on Pension Reform Legislation. The members of the Financial Planning Coalition are the American Institute of Certified Public Accountants, the Consumer Federation of America, the Institute of Certified Financial Planners, the International Association for Financial Planning, the Investment Counsel Association of America, and the Society of Financial Service Professionals. The Certified Financial Planner Board of Standards, Inc. is an educational consultant to the Coalition[1].

BACKGROUND

The convergence of the growing complexity in the financial marketplace, and the shifting of a significant portion of financial and investment decision making from professionals to the American public has created a significant need for financial planning services to be more easily accessible. Financial planning services must include both education and individual professional assistance to help lead individuals through the financial marketplace. The use of education and financial planning assistance will help Americans to effectively manage their finances in ways that allow them to provide for their families today and have a secure and comfortable retirement.

THE CHANGING MARKETPLACE

The financial world that Americans are living in has become increasingly complex. Because of dramatic changes in the way pensions are funded, as well as a growing reliance on personal savings to fund retirement and other major life goals, individuals increasingly make retirement and financial planning decisions that were once made for them by professionals. Even for those who are financially sophisticated, the determination of how much money must be saved for each individual's varied future needs, especially for retirement, and how that money should be invested is difficult. For those who are not financially sophisticated, the complexity of the decisions that must be made and the myriad choices that are available make these decisions truly daunting.

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[1]The American Institute of Certified Public Accountants is the national professional association of CPAs in the United States with more than 330,000 members in public practice, business and industry, government and education.
The Consumer Federation of America is a non-profit association of some 260 pro-consumer groups. It was founded in 1968 to advance the consumer interest through advocacy and education.
The Institute of Certified Financial Planners is a professional membership association that exclusively serves Certified Financial Planner licensees.
The International Association for Financial Planning is the largest and oldest membership association representing the financial planning community, with 123 companies as members of the Broker-Dealer Division and over 17,000 individual members nationwide.
The Investment Counsel Association of America is a national not-for-profit association that exclusively represents SEC-registered investment advisors.
The Society of Financial Service Professionals was formerly known as the American Society of CLU & ChFC. Founded in 1928, it is composed of 32,000 members who are dedicated to serving the financial needs of individuals, families, and businesses.
The Certified Financial Planner Board of Standards, Inc. is a non-profit professional regulatory agency that was founded in 1985. It owns and sets the standards for using the CFP certification mark and the marks CFP and Certified Financial Planner.

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Perhaps the most important change is the sea change in the type of retirement plans of the American worker in the last 20 years. In 1975, sixty eight percent of pension plans were defined benefit plans[i]. These plans defined the amount of the benefit the worker would receive upon retirement very simply – the worker would get a check for a specific amount every month for the rest of his/her life. The worker did not have to make any decisions regarding the amount of money that must be saved for retirement or how to invest the money.

By 1994, fifty percent of pension payments were made from defined contribution plans[ii]. These plans generally require the worker to determine how much to save for retirement and how to invest the money. Cash balance plans are also becoming very popular. They give the employee the flexibility of having a portable pension – one that goes with the worker when there is a change in employers – but they also often require the worker to make investment decisions when there is a change in employers.

Also, workers today change jobs much more often than in previous years, either due to greater opportunities existing in a tight labor market, or due to layoffs accompanying consolidation and downsizing. Changing jobs potentially dilutes a worker's retirement benefits because the worker leaves a position before benefits have vested and/or because some pension provisions disfavor leaving early in a career (e.g. the pension benefit is calculated as a percentage of an employee's top three years of salary).

Another factor has added to the complexity of managing investments and retirement funds. The number and type of investment options has skyrocketed in the last 20 years. Not only have whole new classes of investments been made available, such as Roth IRAs and the complex world of derivatives, but within each type of investment the number of choices has increased exponentially. For example, in 1983, just 15 years ago, there were 1,026 mutual funds to choose from. In 1998, there were 7,314.[iii]

Because of these changes, the ability of each American to retire in comfort increasingly depends on his or her proficiency in making sound investment decisions. And sound investment decisions encompass how much to save for various needs and how to invest the money that is saved. Even for the relatively sophisticated, making the mathematical calculation to determine how much we need to save in order to have a specific income at retirement is not an easy calculation. Seventy-five percent of American workers do not know how much money they will need to reach their retirement goals.[iv]

Yet there is a crisis in savings at the very time that savings is becoming crucial to the long term well being of the American public.[v] The personal savings rate in this country has fallen to a minus 0.7%.[vi] In a 1998 survey taken by the Employee Benefit Research Institute, thirty six percent of those surveyed had no money saved for retirement (a summary of the survey is attached).[vii] These statistics underscore the need to educate Americans about the need for retirement planning.

EFFECT OF FINANCIAL PLANNING

We believe that the cornerstone of retirement income security is proper financial planning and education (attached is a copy of a letter sent to all Members of the Committee on Finance by the Coalition). This was a finding of the 1998 National Summit on Retirement Savings that was held in Washington, D.C. The consensus of the delegates attending the Summit was that the overall solution to the savings crisis is education, provided from qualified sources, and made available to current workers and retirees over an extended period of time. This Summit was mandated by the SAVERS Act and co-hosted by the Administration and Congressional leadership. A 1997 survey by the Consumer Federation of America and NationsBank (now Bank of America) confirms this finding (a copy of the survey is attached). The survey found that savers with financial plans report twice as much savings and investment as do savers with comparable incomes, but without plans.

THE PENSION COVERAGE AND PORTABILITY ACT – S. 741

The Pension Coverage and Portability Act was introduced this year by Senators Bob Graham (D-Fl) and Charles Grassley (R-Ia) and had a total of 14 co-sponsors on June 29, 1999. Section 503 of the bill contains an important first step in making financial planning available to American workers.

Section 503 of this bill does two things. First, it clarifies that the provision of retirement planning services by an employer to employees is a de minimis fringe benefit under Section 132 of the Internal Revenue Code. This is a clarification of existing law. It is clear under current law that it is a de minimis fringe benefit when an employer provides a seminar to a group of employees to provide information about the employer's pension plan. However, it begins to fall into a gray area when the employer adds the availability of a one-on-one meeting for an employee to discuss his/her personal situation, especially when the discussion goes beyond the application of the employer's pension plan and encompasses other aspects of the employee's financial situation.

It is critical that this area be clarified. Retirement planning cannot be done in a vacuum. One of the key questions to be answered is how much money can and should be saved for retirement purposes. Included in this determination must be the consideration of what other assets may be available at retirement, including from sources such as Social Security and a spouse's pension. But that is only the first step. The individual must also determine how much money is currently available to save for retirement. And this can only be determined by looking at the employee's entire financial situation, determining what other needs exist and how much money can and should be allocated for those needs. Examples of some other critical financial needs that must be factored into this calculation are education savings for children and provision to help care for elderly parents.

The second part of Section 503 would allow the employer to create an employee benefit plan for its employees regarding retirement planning that is similar to a "cafeteria plan." This would allow the employer to offer retirement planning or, in lieu of the planning, additional salary. If

the retirement planning service is chosen, there would be no income imputed to the employee by reason of taking the service instead of the salary.

These retirement planning benefits would have to be offered on a non-discriminatory basis. This would ensure that the rank and file employee, not just the highly compensated employee, would have access to the benefit.

Enactment of Section 503 will provide a concrete first step to help Americans achieve retirement security. This is a first step because it will only reach a limited number of people. Not all employers will offer these benefits to their employees. Large employers will be more likely to offer such benefits than will small employers. And self-employed individuals, independent contractors, and part time employees who do not receive a full range of benefits will not receive these or other retirement planning services.

CONCLUSION

Financial planning and education has become a critical element of every American's ability to live and retire in comfort. Not only do people save more, but they save smarter when they have the proper education and tools. Unfortunately, the provision of education and financial planning tools is trailing the changes in the marketplace that are making them necessary.

Section 503 of S. 741 is a good starting point in the move to make financial planning services and education available to all Americans. If Section 503 is enacted, a substantial number of Americans will have access to financial planning services that were previously unavailable. And the provision of these retirement planning and education services will prove their worth when they cause a substantial number of workers begin to save for retirement that have not done so yet, and cause workers who are saving for retirement to save more and to invest it more wisely. Section 503 offers a foundation upon which other efforts to increase American's access to financial planning services can be built.

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[i] Employee Benefit Research Institute Databook on Employee Benefits, 4th Edition.
[ii] Id.
[iii] 1999 Mutual Fund Fact Book, 39th Ed., pub. By the Investment Company Institute.
[iv] Yakoboski and Dickemper, Increased Saving but Little Planning: Results of 1997 Retirement Confidence Survey, Employee Benefit Research Institute Brief (Nov. 1997).
[v] The SAVER Act (P.L. 105-92 (1997)) (passed unanimously by Congress) noted that we have a crisis of savings in this country.
[vi] Advisory from the Committee on Ways and Means of the United States House of Representatives, No. FC-10, June 2, 1999.
[vii] 1998 Retirement Confidence Survey by the Employee Benefit Research Institute.

Summary of Findings

1998 Retirement Confidence Survey

Despite recent economic booms, Americans' **confidence** in their golden years **has not increased.** In fact, through the last six years a steady 20 percent to 25 percent of working Americans have indicated they are very confident they will have enough money to live comfortably throughout their retirement. A slightly higher proportion— about one-third—are not confident about their income prospects today. The number of working Americans not confident has increased slightly in six years—up from about one-quarter in 1993.

When considering **specific aspects** of retirement, workers today are most concerned that they will not have enough money for long-term care. About one-third are not confident about having enough money for medical expenses, leisure pursuits, or to support themselves no matter how long they live.

There is an **increase in** the number of Americans who are **attempting to calculate** what they need to have saved for their retirement. In 1998, just less than one-half of workers report they have made the calculation (45%), while in prior years just one-third had done so (32% in 1996). When looking into this increase further, we find that it is primarily driven by aging baby boomers who are waking up to retirement realities.

One-third of Americans are not saving for retirement (36%). According to the Retirement Confidence Survey (RCS), most believe they have too many current financial responsibilities to be able to save for retirement. Despite this, more than one-half of both savers and nonsavers agree they could afford to save an additional $20 a week more than they are currently saving for retirement. The sacrifices they would make include dining out less and spending less money on entertainment.

Among those who are saving for retirement, **fear appears to be a strong motivational factor** in prompting them to begin putting away money for retirement. Workers indicate that seeing people not prepare and therefore struggle in retirement or realizing that time was running out for preparing are two of the strongest motivators.

The RCS also reveals that **employer-provided retirement planning information** can have a measurable and positive impact on savings behaviors. Respondents who indicate they have received information from an employer are more inclined to be saving for retirement and to have calculated how much they need to have saved prior to retirement; many report that employer-provided information is a useful source of retirement savings investment information.

This year, the eighth annual RCS takes a closer look at **three specific minority groups** in America. We find that Hispanic-Americans are less likely to be saving for retirement than are African-Americans, Asian-Americans, or whites. Both African-Americans and Hispanic-Americans are less confident about many specific aspects of retirement, including: having enough money for leisure activities, to support themselves no matter how long they live, and for basic expenses during retirement. *(Note: Throughout this summary, significant differences among ethnic groups are noted where relevant.)*

Confidence in Retirement

The 1998 RCS finds more than four out of five Americans do not believe that people in the United States save enough money for retirement (82%); this perception has remained unchanged for the past seven years. Just seven percent of all Americans say that people do save enough money for retirement. Similar proportions of retirees and workers say people save enough (7% v. 9%, respectively). Hispanic- and Asian- Americans are more likely to believe people save enough for their retirement (15% and 19%, respectively).

Three of five Americans are very or somewhat confident they will have enough money to live comfortably throughout their retirement (61%). However, more than one-third (36%) are not confident about it. Confidence has decreased this year, down eight points from 69% in 1997. This drop in confidence is primarily driven by a significant drop in retirees' confidence— from 74% confident to just 51% confident.

The 1998 RCS shows that workers' general confidence has remained steady since 1997, confirming an observed increase in the proportion of workers not confident they will have enough money for a comfortable retirement since the question was first asked in 1993 (26% not confident in 1993, 31% not confident today).

African-Americans are significantly less confident that they will have enough money for a comfortable retirement. Just one-half are very or somewhat confident (50%). Nearly as many are not confident about having enough money (49%).

Older baby boomers are significantly less confident today than they were last year. In 1997, one-quarter of older baby boomers indicated they were not confident they would have enough money for a comfortable retirement (26%). The 1998 RCS finds that number has increased to more than one-third not confident (35%). Workers who are significantly more concerned about retirement this year are those with $25,000 to $35,000 in annual household income (35% v. 41% not confident in 1998). Among generation X-ers, a smaller proportion express low confidence this year than last (32% not confident in 1997, 24% in 1998).

Among workers, there has been a significant drop in confidence about financial preparation for retirement since the 1997 RCS (from 32% to 25% very confident). Workers are also less confident about having enough money for basic expenses (from 44% to 38% very confident). Among both retirees and workers, confidence in having money for leisure pursuits has declined significantly—among workers there has been an eight point decline (from 25% to 17% very confident); among retirees there has been a six-point decline (from 38% to 32% very confident).

Hispanic-Americans are less confident about each specific aspect of retirement. African-Americans are less confident about four of the six specific aspects of retirement inquired about: having enough money for 1) basic expenses, 2) leisure pursuits, 3) long-term care, and 4) supporting themselves no matter how long they live.

Sources of Income in Retirement

Retirees today are relying on Social Security as their most important source of income (42%). Just 13% of workers are expecting to rely on Social Security as their most important source of income. Retirees are less likely than workers to indicate that an employer-based plan is their most important source of retirement income (9% v. 23%) or other personal savings (10% v. 16%).

In the 1998 RCS, workers indicate they are going to rely on their own personal savings less than they have in previous years. In 1997, one-half of workers (51%) saw savings from work-related plans they contribute to or other personal savings as the most important source of retirement income; only 39% feel that way today. Specifically, workers who are nearing retirement age and older boomers are significantly less likely to indicate personal savings will be their most important source of retirement income. Just three in ten pre-retirees or older baby boomers are going to rely on personal savings (30% and 29%, respectively), while a majority of generation X-ers expect to rely on personal savings (52%).

Asian-Americans have significantly higher proportions who report they are expecting money they saved through a work-based retirement plan to be a major source of income (49% v. 38% of all Americans). Both Asian-Americans and Hispanic-Americans are more likely to say they expect that employment (24% of Asian-Americans, 30% of Hispanic-Americans v. 14% of all Americans) or

family support (10% of Asian-Americans, 14% of Hispanic-Americans v. 3% of all Americans) will be a major source of income. For Hispanic-Americans, other government programs, such as veterans' benefits or SSI are significantly more likely to be a major source of retirement income (17% v. 6% of all Americans).

Determining a Savings Goal

The proportion of workers who have attempted to figure out how much money they need for retirement has increased nine points from 1997 (45% from 36%). However, a majority of current workers still have not attempted to calculate how much money they will need to accumulate for retirement (54%). Only one in five Hispanic-Americans has attempted to calculate how much he or she would need for retirement (22%), significantly fewer than other Americans.

The 1998 RCS reveals that the increase in workers who attempt to determine a savings goal is largely due to significant proportions of baby boomers who are now planning for retirement. About one-half of boomers in the 1998 survey report they have tried to make this calculation (48%), while in 1997, just one-third had (34%). The 1998 results also show that working men are more likely than working women to have attempted the calculation (49% v. 40%).

Savers

This year's RCS finds that 63% of Americans have saved for retirement. The proportion is similar among workers (63%) and retirees (65%). Among those who are not personally saving for retirement, about one-quarter say they have some funds earmarked for retirement (23%). One-quarter (26%) of workers say they have funds earmarked for retirement, while one in six retirees indicates the same (16%); however, this is not a significant difference. In total, seven out of ten Americans have money, aside from Social Security, specifically designated for their retirement (72%).

Not surprisingly, workers who are nearing retirement have a higher proportion of people who have accumulated funds for retirement (78%) than generation X (65%). Men are more likely than women to indicate they have begun saving for retirement (69% v. 57%).

Among minorities, Asian-Americans are more likely than African-Americans or Hispanic-Americans to indicate they have begun saving for retirement (62% of Asian-Americans are saving). Majorities of African-Americans (52%) and Hispanic-Americans (62%) indicate they are not currently saving any money for retirement.

Working savers report that the strongest sources of motivation to start saving for retirement have been seeing people who have not prepared and have struggled (48%) or realizing that time is running out to prepare for retirement (37%). For one-third of working savers, the availability of a plan or educational material in the work place provided a lot of motivation (33%). For one-quarter, it is a family event that prompts them to act (25%). A few are motivated to save through a professional financial advisor (18%), the media (17%), or advice from family or friends (15%).

Could Americans Save at Least $1,000 a Year?

Significant majorities of both savers and nonsavers say they could save $20 per week more than they are saving now for retirement. If this were the case, Americans could save an additional $1,040 a year.

In total, over one-half of workers indicate they think they could save $20 more than they are saving for retirement now (56%). The number who believe they could save an extra $20 is similar for those who are already saving (57%) and those who are not (55%). In order to save the additional money, most would give up dining out and some entertainment.

Investing for Retirement

Less than one-half of workers who are saving for retirement are very confident that they are investing those retirement savings wisely (46%). A similar proportion is just somewhat confident about their investments (47%). Workers nearing retirement age (between 55 and 64) have the highest proportion who are very confident they are investing wisely (53%), while the least confident are the younger baby boomers, of whom just more than one-third are confident about their investments (38%). Working men report higher confidence in their investments than do women (52% v. 38%).

Three of ten savers indicate they do not like to make investment decisions regarding their retirement savings (31%). A majority say they enjoy making investment decisions (64%). Among savers who are currently working, generation X-ers are more likely than others to report they enjoy making investment decisions (72%). Males are more likely than females to report they enjoy these types of decisions (70% v. 53%).

When making their investment decisions, savers most often indicate they use input from a spouse or partner (79%). A majority also use written material provided by a retirement plan from their work place (55%), other written material (57%), or the advice of a financial professional (51%). Four of ten savers indicate they use the advice of family or friends (43%) and information from television or radio (37%). Half as many use information from seminars (23%), computer software (15%), or the Internet (18%). Among those who use these resources, the advice of a financial professional was considered the most helpful (28%); spouses (18%) and information from the work place (15%) also receive many votes as most helpful.

A vast majority of savers say they want descriptions of their options when making retirement fund investment decisions (82%). Six out of ten would like to have specific recommendations, examples of investment packages for workers at different ages, or worksheets that show how much they need to save.

Nonsavers

In total, slightly more than one-third of working Americans are not personally saving money for retirement (36%). The major reason workers who are not saving give for not saving for retirement is that they have too many current financial responsibilities (66%). Half as many indicate economic events such as inflation and unemployment as major reasons for not saving for retirement (31%). About one-quarter indicate they do not save because they are not offered a retirement savings plan at work (25%), they feel they have plenty of time until retirement (27%), or they are expecting a pension (28%). Just slightly fewer are not saving because they do not believe they will retire (19%), they just have not thought about it (21%), or they believe retirement will work itself out (20%).

White Americans are more likely than minorities in America to say a major reason why they cannot save is because they have too many financial responsibilities. Hispanic-Americans are more likely to indicate they are expecting Social Security to take care of them (27%), their children will help out (16%), or they just have not thought about retirement (32%). For one-third of Spanish-speakers, not being able to find information in Spanish is a major reason they have not begun to save for retirement (32%)

Today's Retirees

Many retirees say that retirement has exceeded their expectations. Two of five believe their overall standard of living and having money for entertainment and leisure is better than they expected (40% each). Around one-third say having money to assist family members and cover medical expenses is better than they expected (32% and 34%, respectively). However, between one-fifth and one-quarter say these elements have declined. Money for helping family members and for leisure pursuits are considered worse than expected by about one-quarter (26% each). For one-fifth, their overall standard of living and having money for medical expenses is worse (20% and 22%, respectively).

Around one-quarter have worked for pay since they retired (24%), most indicating they worked

part-time (18%). They say that major reasons for working are because they enjoyed it and wanted to stay involved (56%) or they wanted a satisfying way to spend their time (44%). However, one-third point to a need for money to buy extras (34%), and one-quarter need the money to make ends meet (28%).

Workers Today

Workers are expecting to work longer than today's retirees did. However, about one-half still indicate they expect to retire prior to age 65 (49%). One-third indicate they do not expect to retire prior to age 65 (34%). Nine percent indicate they do not plan to retire. While almost one-half of generation X-ers say they expect to retire no later than age 60 (45%), half as many pre-retirees believe they will retire that early (21%).

About one-half of workers expect to be retired for 20 years or more. One-quarter indicate they expect to be retired for 20 years (26%), and another quarter expect to live more than 20 years in retirement (25%). Another quarter believe they will be retired for less than 20 years, while yet another quarter indicate they do not know how long they will be retired. Younger Americans, generation X-ers, and young baby boomers are expecting to live in retirement longer than Americans nearing retirement age—57% of generation X-ers expect to live 20 years or more in retirement, compared with just one-third of pre-retirees (36%).

Sixty-one percent indicate they expect to work after retirement. Younger baby boomers are most inclined to believe they will work for pay during their retirement (67%). The most commonly cited reasons are because they enjoy working and want to stay involved (60% say it is a major reason) or they want a satisfying way to spend their time (56%). However, nearly one-half expect to work for money to buy extras (46%), while more than one-third will work for money to make ends meet (38%).

Role of the Employer in Retirement Savings

About two in five working Americans report that they have received retirement planning and/or savings material from an employer in the past 12 months (39%). Those who are saving for retirement are more likely to have received information from an employer (45%) than those who are not saving (28%). Among minority Americans, Hispanic-Americans are significantly less likely to receive retirement savings material from an employer; just one-quarter report they received information (28%).

Workers who receive information from employers indicate the materials provided changed their savings or investment behavior in some way. Many changed the amount they contribute to a retirement savings plan or changed the allocation of money in a plan (43% each). A similar proportion of workers say they began to contribute to a plan (41%).

The most popular form of employer-provided retirement planning material is brochures (45%), followed closely by seminars (32%) and newsletters or magazines (25%). Less than one in five were provided with workbooks (17%), one-on-one counseling (15%), or telephone access to financial information (12%). Very few employers provide employees with retirement savings information in the form of online information, computer software (4%), or videos (5%).

These findings are part of the eighth annual Retirement Confidence Survey (RCS), a survey that gauges the views and attitudes of working and retired Americans regarding retirement, their preparations for retirement, their confidence with regard to various aspects of retirement, and related issues. The survey was conducted in March 1998, through 22-minute phone interviews with 1,500 individuals (1,142 workers, 358 retirees) ages 25 and older. Random digit dialing was used to obtain a representative cross section of the U.S. population. This year's project also includes a special analysis of minority groups, specifically African-Americans,

Hispanic-Americans, and Asian-Americans.

The RCS is co-organized by the Employee Benefit Research Institute (EBRI), a private, nonprofit, nonpartisan public policy research organization; the American Savings Education Council (ASEC), a partnership of more than 250 private- and public-sector institutions dedicated to raising public awareness of what is needed to ensure long-term personal financial independence, a part of the EBRI Education and Research Fund; and Mathew Greenwald & Associates, Inc. (MGA), a Washington, DC-based market research firm.

The 1998 RCS data collection was funded by grants from 33 public and private organizations, and the special report on minorities data collection was funded by grants from 14 organizations. Staffing was donated by EBRI, ASEC, and MGA. RCS materials and a list of underwriters may be accessed at the EBRI website: www.ebri.org/rcs.

AICPA
ISO9001

May 24, 1999

The Honorable William V. Roth, Jr.
U.S. Senate
104 Hart Senate Office Bldg.
Washington, DC 20510-0001

Dear Senator Roth, Jr.:

Re: **RETIREMENT PLANNING IS CRITICAL TO ENSURE THE FUTURE SECURITY OF THE AMERICAN WORKER**

We are writing to ask you to support legislative endeavors which would make retirement planning more available to the American workforce. A proposal contained in both H.R. 1102 and S.741 would make it clear that the value of employer provided retirement planning assistance is not a taxable fringe benefit to an employee.[1]

The ability of each American to retire in comfort increasingly depends on his or her proficiency in making sound investment decisions. This means that the cornerstone of retirement income security is proper financial planning and education.[2] Recent surveys and studies have underscored the critical need for retirement planning education among today's workers.

- Only one in three savers has a comprehensive retirement plan.[3]
- 75% of America's workers do not know how much they will need to reach their retirement goals.[4]
- 36% of those surveyed have no money saved for retirement.[5]
- Of all workers, only 39% received employer provided educational material about retirement planning.[6]

Evidence also exists that **retirement education is a key element in ensuring retirement security for workers:**

- Savers with financial plans report twice as much savings and investments as do savers without plans.[7]
- 81% of workers who received retirement education have money earmarked for retirement in an account.[8]

American Institute of Certified Public Accountants
1455 Pennsylvania Avenue, NW, Washington, DC 20004-1081 (202) 737-6600 • fax (202) 638-4512

The Honorable William V. Roth, Jr.
May 24, 1999
Page Two

These findings are both alarming and encouraging. It means that many of today's workers will reach and are reaching retirement age with **too little income for retirement**. These findings also provide hope. The studies show that those individuals that receive retirement education significantly increase their savings and investments. **If we are to encourage national savings,** we must encourage education to empower each American to make the most of his or her investment choices. **Retirement planning services** provided by employers to their employees **must be encouraged** and promoted but – **should not be taxed!**

Sincerely,

The American Institute of Certified Public Accountants
Certified Financial Planner Board of Standards, Inc. (as an education consultant to the AICPA)
Consumer Federation of America
Institute of Certified Financial Planners
Investment Company Institute
Investment Counsel Association of America
Securities Industry Association

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[1] Sec. 520 and Sec. 503 respectively of H.R. 1102, *the Comprehensive Retirement Security and Pension Reform Act* (the Portman-Cardin bill) and S. 741, *Pension Coverage and Portability Act* (the Grassley-Graham bill).

[2] The SAVER Act (P.L. 105-92 (1997)) (passed unanimously by both houses of Congress) noted that we have a crisis of savings in this country. A summit was mandated by this law to establish recommendations to encourage savings. One of the main findings of the 1998 National Summit on Retirement Savings (co-hosted by the Administration and Congressional leadership) was that employers must be urged to "educate employees about the importance of retirement savings".

[3] 1997 Survey by Consumer Federation of America and NationsBank (now Bank of America).

[4] Yakoboski and Dickemper, Increased Saving but Little Planning: Results of 1997 Retirement Confidence Survey, Employee Benefit Research Institute Brief (Nov. 1997). (hereinafter cited as the Yakoboski study).

[5] 1998 Retirement Confidence Survey by the Employee Benefit Research Institute. (Hereinafter cited as the Retirement Confidence Survey).

[6] Retirement Confidence Survey.

[7] 1997 Survey by Consumer Federation of America.

[8] Retirement Confidence Survey.

NationsBan

HOLD FOR RELEASE UNTIL:
May 5, 1997, 10 a.m. EDT

Contact:
Erin Wechsler or
Scott Stapf, 703/276-1116

SURVEY: TWO OUT OF THREE SAVERS ARE WITHOUT FINANCIAL PLANS, UNLIKELY TO ACHIEVE GOALS

But New Data Also Shows Surprisingly Big Benefits For Those With Plans; Financial Planning Is Key to Progress Toward All Goals, Doubling of Savings.

WASHINGTON, D.C.///MAY 5, 1997///An estimated **65 million American households** will probably not realize one or more of their major life goals, largely because they have failed to develop a comprehensive financial plan, according to a major new survey released today by the Consumer Federation of America (CFA) and NationsBank. The good news in the findings is that Americans who mend their ways and start planning can expect to see surprisingly dramatic benefits: **In households with annual incomes of less than $100,000, savers who say that they have financial plans also report about twice as much savings and investments as do savers without plans.**

To boost public understanding of the "financial planning crisis" and how best to tackle it on the individual level, CFA and NationsBank announced today that they would undertake a major educational outreach campaign, consisting of nationwide distribution of educational materials, a 10-city series of free public seminars on personal finances and planning, and, beginning later this year, continuing education through the NationsBank Website at <www.nationsbank.com>.

The CFA/NationsBank survey shows that while more than four in five households are saving something for at least one of their goals (most often retirement or an emergency fund), two out of three have not saved the first dollar toward other key goals, such as sending a child to college or scraping together a down-payment for a new home. Only about one in three savers now has a comprehensive financial plan, according to the new CFA/NationsBank data. (*See detailed data below under "Key Survey Findings."*)

"In the past, we've simply stressed the importance of savings," noted Consumer Federation of America Executive Director Stephen Brobeck. **"Now, as a result of our research, we will emphasize that developing a financial plan is the most effective way to achieve saving goals. That is because planning itself leads to increased savings. Also, for many Americans, it is the best way to feel better about savings progress."**

The CFA/NationsBank survey reveals that the link between financial planning and the level of accumulated savings is stronger than that between knowledge of basic savings issues and resulting savings.

"This research makes it clear that you don't have to be a financial expert to be financially successful," said NationsBank President Ken Lewis. "What's most important is that you have a plan to reach your goals. Americans of all income levels are more comfortable, confident, and are making more progress toward their goals -- *if* they have a financial roadmap."

AARP President-Elect Joseph S. Perkins said: "Too many Americans make the mistake of thinking that the future is somehow going to take care of itself. The reality is when it comes to retirement, paying medical bills and meeting other needs, you've got to take responsibility for saving and planning for your future."

<u>KEY SURVEY FINDINGS</u>

The extensive CFA/NationsBank survey, ***"Planning for the Future: Are Americans Prepared to Meet Their Financial Goals?,"*** represents an unprecedented attempt to gauge the savings patterns, major financial goals and progress of typical Americans. From the wealth of resulting data, the following are among the key findings:

- ***Most Americans are trying to save, but still come up short in terms of their goals because of a lack of financial planning.*** The vast majority of American households (84 percent) report setting aside some savings for at least one of their financial goals. At the same time, most American households (63 percent) also indicate that they are yet to begin saving for at least one of their major goals. This disparity between the substantial number trying to save and their overall lack of progress toward all key goals reflects the fact that only a third (32 percent) of savers have a comprehensive financial plan in place.

- ***Americans are starting to get serious about their retirement years, but, because of a lack of financial planning, are off track in saving for other life goals.*** Most Americans have a distinctly haphazard approach to saving for the future. While majorities of households have saved at least something for retirement (64 percent of non-retired households) and put some kind of emergency fund in place (68 percent), the percentages of those who have saved for other goals are low: buying a new home in the next 10 years (34 percent); college education of an existing child (56 percent); a major purchase in the next two years, such as a new auto, a major vacation, or a home improvement project (51 percent); and help during the next 20 years with the medical expenses of a parent or other older relative (17 percent).

- ***Americans with financial plans can double their savings.*** Financial planning is more than just a good idea, it also is an extremely lucrative one, according to the CFA/NationsBank survey data. Having a financial plan in place means that an otherwise typical household will set aside up to more than twice the savings of non-planning households.

HOUSEHOLD INCOME	MEDIAN SAVINGS (NON-PLANNERS)	MEDIAN SAVINGS (PLANNERS)
$20,000-$39,999	$14,300	$28,500
$40,000-$99,999	$41,500	$89,650
$100,000 and up	$201,100	$325,500

- ***One in five American households are "non-savers," with nothing saved for their major goals.*** American households fall into one of three camps: **super-savers** (37 percent), who have at least some money set aside for all their goals; **semi-savers** (45 percent), who have some money set aside for some of their goals, but none saved for others; and **non-savers** (18 percent), who have set aside no money for any of their goals. Financial planning is the litmus test that can be used to distinguished most "super-savers" from individuals in the other two categories. While six out of 10 (61 percent) of those with a financial plan qualify for "super-saver" status, only about a third (36 percent) of those without a financial plan reported that they have savings set aside for each of their financial goals.

- ***Financial planning delivers benefits even to "financially illiterate" savers.*** Surprisingly, for all but the very affluent, financial planning appears to be even more important to success than a good grasp of basic saving and investment concepts. Based on a 14-question test of basic personal finance knowledge, fewer than one in 10 (8 percent) savers can be considered financially literate. Six in 10 (61 percent) got fewer than half the questions correct and the average score was only 42 percent. The correlation between financial literacy and accumulated savings was weaker than that existing between having a financial plan and accumulated savings.

- ***Substantial anxiety exists about savings progress, products and knowledge.*** While 59 percent of American households report that they are saving like "clockwork," roughly the same number (57 percent) feel that they are behind saving for their major goals. Only a third (35 percent) of all savers feel they are very confident about how to manage their money, and even fewer (29 percent) say they are rarely, if ever, confused about what they read and hear about investments. Here again the beneficial impact of financial planning may be seen in the fact that 48 percent of savers with a plan feel confident about making the best financial decisions, versus only 28 percent of savers without a financial plan.

CFA/NATIONSBANK TO PUSH FOR MORE SAVING

As a result of the new survey findings, the Consumer Federation of America and NationsBank offered the following simple five-step approach to starting a financial plan:

⇨ **SET GOALS.**

⇨ **START SAVING!**

⇨ **MATCH INVESTMENTS TO GOALS.**

⇨ **DO ANNUAL CHECK-UP.**

⇨ **CHOOSE HELP WISELY.**

A description of how to put each tip to work is set out in the attached document, **"How To Start Your Financial Plan,"** which is available free from the Consumer Federation of America and on the NationsBank Web site. *(See end of this news release for details on both.)*

CFA's Brobeck said: **"It is critically important for all Americans who are not meeting their savings goals to develop a financial plan. They can begin to do this themselves by using a public library or even the Internet to search for credible information."**

The CFA/NationsBank national education campaign, to be launched later this year, will distribute "how-to-plan" materials through local community and consumer advocacy organizations nationwide. At the seminars, nationally known personal finance experts will provide tips and information aimed at helping more Americans to plan. The list of the 10 cities in which CFA/NationsBank seminars will be held encompasses 26 million Americans: **Albuquerque; Atlanta; Baltimore; Charlotte, Dallas, Kansas City; Orlando; Richmond; St. Louis; and Tulsa.**

SURVEY METHODOLOGY

The joint CFA/NationsBank survey, ***"Planning for the Future: Are Americans Prepared to Meet their Financial Goals?,"*** included in-depth telephone interviews conducted by Princeton Survey Research Associates (PSRA) with a representative sample of financial decisionmakers in 1,770 households nationwide, including 1,533 households that had already accumulated savings. Interviews took place between January 17-February 23, 1997. The margin of sampling error for results based on the total sample or based on the subsample of savers is ± 3 percentage points at the 95 percent level of confidence.

The survey, conducted by Princeton Survey Research Associates, asked questions about the household's financial goals, the household's strategy for saving and investing, and the decision-maker's knowledge about important financial matters. Six financial goals were investigated in depth: saving for emergencies; retirement; college; down-payment on a home; major purchase; and helping an older relative with medical or living expenses. In all cases where respondents are evaluated in terms of their goals, the respondents affirmatively indicated that they actually had the goal in question For example, only those parents indicating that at least one of their children would go to college were evaluated in terms of savings for that particular goal.

ABOUT THE ORGANIZATIONS

The Consumer Federation of America is a non-profit association of some 240 pro-consumer group that was founded in 1968 to advance the consumer interest through advocacy and education.

NationsBank has retail and commercial banking operations in 16 states and the District of Columbia. With total assets of $239 billion as of March 31, 1997, it ranks as the fourth-largest U.S. banking company.

AARP is the nation's leading organization for people 50 and older. It serves their needs and interests through research, advocacy, informative programs and community services provided by a network of local chapters and experienced volunteers throughout the country. The organization also offers members a wide range of special benefits, including Modern Maturity and the monthly Bulletin.

FOR MORE INFORMATION, CONTACT:
Erin Wechsler or Scott Stapf, 703/276-1116

AFTER MAY 5TH, CONTACT:
Barbara Roper, CFA, 202/387-6121
John Cleghorn, NationsBank, 704/386-8571
Katie Sloan, AARP, 202/434-6040

COPIES OF THE EXECUTIVE SUMMARY OF THE CFA/NATIONSBANK SURVEY ARE AVAILABLE UPON REQUEST FOR JOURNALISTS.

A ONE-PAGE SUMMARY OF HOW TO START A FINANCIAL PLAN ARE AVAILABLE AT NO COST TO CONSUMERS WHO SEND A STAMPED SELF-ADDRESSED ENVELOPE TO: *"FINANCIAL PLANNING,"* CONSUMER FEDERATION OF AMERICA, PO BOX 12099, WASHINGTON DC 20005.

SURVEY HIGHLIGHTS AND FINANCIAL PLANNING TIPS FOR CONSUMERS ARE AVAILABLE FOR THE GENERAL PUBLIC AT THE FOLLOWING LOCATION ON THE NATIONSBANK WEB SITE: <www.nationsbank.com/info/html/saverssurvey.htm>

HOW TO GET STARTED ON YOUR FINANCIAL PLAN

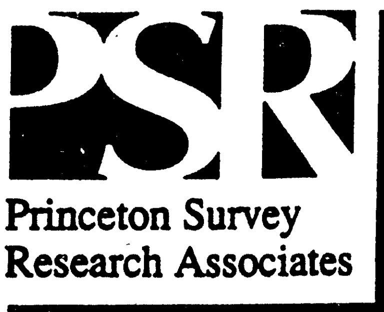
➪ **SET GOALS.** Should you be saving for a down-payment on a new home, the college education of your children, a comfortable retirement, or something else? Figure out what your major goals are, how much it will cost to reach them, and the number of years that you have to build up your savings.

➪ **START SAVING!** Your savings shouldn't depend on whatever happens to be left over at the end of the month. Based on your goals and how much you need to save to reach them, start setting aside something toward each goal every month ... and put it in separate accounts. The best way to make sure that you have money to save is to put yourself on a budget based on your income and expenses.

➪ **MATCH INVESTMENTS TO GOALS.** Now, the big question is: Where should you put your money? The answer depends on how much time you have to save, your age, your income, and so on. Take time to learn about the best types of savings and investment products for each of your goals. An important point: Choosing the right type of investment is more important than choosing the very "best" product of that type. **Never** buy an investment that you don't understand. **Always** make sure that any investment you buy makes sense as part of your overall financial plan.

➪ **DO ANNUAL CHECK-UP.** Have your goals changed? How are your investments doing? Could you save even more? These are the questions that you should ask at least once every year. Pick a specific date, such as New Year's Day or your birthday, and then spend an hour or two giving your financial plan a good close look for possible improvements.

➪ **CHOOSE HELP WISELY.** You may be able to put together and carry out your financial plan on your own. Public libraries, book stores and the Internet are good sources of information about financial planning strategies, as well as the savings and investment products used to carry them out. If you decide that you need the help of a financial professional, determine in advance what services you want to get and then interview two or three properly licensed professionals who specialize in your needed services, are experienced, and have clean disciplinary records. Make sure you know how your financial adviser is going to be compensated and the total cost of getting his or her advice and putting it into action.



PLANNING FOR THE FUTURE:
ARE AMERICANS PREPARED
TO MEET THEIR FINANCIAL GOALS?

A Summary of Key Findings

Prepared for:
NationsBank and the Consumer Federation of America

Prepared by:
Princeton Survey Research Associates

Princeton Survey Research Associates
911 Commons Way
Princeton, New Jersey 08540
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EXECUTIVE SUMMARY

The vast majority of Americans are making some effort to prepare financially for the future, but most are falling short in reaching their financial goals. The critical factor, aside from income, that distinguishes those who are relatively successful is preparation of a comprehensive financial plan. Whatever their income, people with a plan save more money, save in smarter ways, and feel better about their progress than people without a plan. By comparison, knowledge of basic savings and investment principles has a more modest effect on savers' behavior.

The Importance of Planning

Having a financial plan dramatically increases the amount of savings that households set aside toward their financial goals, even in households with relatively modest incomes. For example:

* among households with incomes between $20,000 and $39,999, the median total savings reported by planners ($28,500) is twice that of non-planners ($14,300);

* among households with incomes between $40,000 and $99,999, those who plan report having savings of $89,650, more than twice the $41,500 set aside by non-planners; and

* among households with incomes of $100,000 and above, the gap, though less dramatic, remains substantial, with planners amassing savings of $325,500 compared to $201,100 saved by non-planners.

Similarly, planners are more likely to have some money saved for all of their goals than non-planners. Six in ten savers with a plan (61%), but only a third (36%) of those without a plan, have some money saved for each of their financial goals.

In addition to increasing their overall level of savings, having a plan also improves savers' behavior in other ways. For example, 88 percent of planners compared to 57 percent of non- planners make an annual contribution toward retirement. Among those who expect to send a child to college, seven in ten planners (68%) compared to 56 percent of non-planners have their college savings in a separate account designed to provide long-term growth. And nearly half of planners (48%) compared to a quarter of

* among households with incomes between $40,000 and $99,999, those with high knowledge scores reporting having $72,000 in savings, compared to $48,600 for those with lower scores; and

* among households with incomes of $100,000 or more, those with high knowledge scores report having $423,600 in savings, well more than double the $174,900 reported by those with low knowledge and also more than the $325,500 reported by those in this income bracket who have a plan.

In addition, 57% of those with higher knowledge scores report having some money set aside for each of their goals, compared to 40% of those with lower knowledge scores.

Knowledge scores are based on a 14-question test of knowledge included as part of the survey. Despite the fact that questions were directly related to goals identified by the respondents, only eight percent of savers got at least three-quarters of the questions correct. Six in ten (61%) got fewer than half the questions correct, and the average score was only 42 percent.

The Lack of Savings Progress

The role of planning in American's financial success gains even greater importance in light of what the study reveals about Americans' general lack of savings progress and their often poor saving and investment decisions.

On the positive side, the report finds that 84 percent of households have some money set aside for at least one financial goal, such as retirement, college, or emergencies. Also, savers are making most progress in saving for two key goals -- retirement and emergencies. Two-thirds (64%) of non-retired households report having some money set aside for retirement, and, in a separate question, nearly seven in ten (69%) say they make some type of an annual contribution toward retirement. About the same number (68%) say they have some money set aside for emergencies, and nearly three-quarters of those (73%) say they have set aside at least the three months worth of living expenses financial experts generally recommend as a minimum.

On the other hand, nearly two-thirds (63%) identify at least one financial goal for which they have no money saved. For example, eight in ten (82%) of those who expect to help a parent or other older relative with living or medical expenses during the next two decades have no money set aside for this purpose, nor do two-thirds (66%) of those who expect to buy their first house in the next ten years. It is not surprising, then, that nearly six in ten (57%) say they feel behind in saving for at least one of their major goals. As would be expected, those with more limited means are far more likely to feel behind in saving for their goals than the affluent. For example, only 18 percent of non-retired

an older relative with living and medical expenses. Individuals can dramatically improve their saving success, however, simply by getting their finances in order and developing an overall financial plan. Furthermore, the fact that most Americans are trying to prepare for the future and understand that they are falling behind means they may be receptive to education programs designed to help them take control of their finances and may be willing to take the necessary steps to get their savings on track.

Methodology

Conducted by Princeton Survey Research Associates from January 17 through February 23, 1997, the survey included in- depth telephone interviews with a representative sample of financial decision-makers in 1,770 households nationwide, including 1,533 households that had accumulated some savings. Questions covered the household's financial goals, the household's strategy for saving and investing, and the decision- maker's knowledge about important financial matters. Six financial goals were investigated in depth: saving for emergencies, for retirement, for college, for a down payment on a house, for a major purchase, and to help an older relative with medical or living expenses. The margin of sampling error for results based on the total sample or based on the subsample of savers is plus or minus three percentage points at the 95 percent confidence level. (A more detailed description of the survey methodology and a questionnaire annotated with the complete survey results are included in the survey report.)

[i] For the purposes of this analysis, those considered to have higher knowledge scores are those who got 60 percent or more of the questions correct on the test of financial knowledge included in the survey.

Investor Education Survey

Princeton Survey Research Associates for
NationsBank and The Consumer Federation of America

Final Topline
February 28, 1997

N= 1,770 financial decision-makers, including 1,533 "savers"
Margin of error: plus or minus 3 percentage points for the total sample and plus or minus 3 percentage points for the sample of savers
Dates of interviewing: January 17 - February 23, 1997

Sample is a high income skewed random sample that, when weighted, is projectable to total households in the continental U.S. All percentages below are weighted.

INTRODUCTION: Hello. I am (NAME) calling for Princeton Survey Research of Princeton, New Jersey. We are conducting a national OPINION survey about some important issues facing Americans today, and I'd like to ask a few questions of the person who USUALLY MAKES THE FINANCIAL DECISIONS for this household.

IF NECESSARY: This is an OPINION survey about financial decisions facing average Americans, and it's very important to have the opinions of all different kinds of people. I am not selling anything, and no one will ever call you back to try and sell you anything. Everything you tell me in this interview is COMPLETELY confidential.

1. How would you describe your own personal financial situation? Would you say you

38	Live comfortably
30	Meet your expenses with a little left over for extras
22	Just meet your basic living expenses, OR
9	Don't even have enough to meet expenses?
1	Don't know
100	

2. I'm going to read some statements that describe how some people feel about money and planning for the future. For each one, please tell me how well you would say it describes you—very well, somewhat well, not too well, or not at all.

	Very Well	Somewhat Well	Not too Well	Not at All	DK	
a. I have a habit of saving money regularly, like clockwork.	29	30	22	18	1	=100
b. To me, investing seems complicated.	26	29	20	25	*	=100
c. I prefer not to think about money.	18	24	22	35	1	=100
d. Unexpected expenses make it hard for me to stick to a budget.	29	29	20	21	1	=100
e. I like to know exactly where my money is spent each month.	64	23	7	5	1	=100
f. It's hard for me to know who to trust for financial advice	28	26	18	27	1	=100
g. I'm worried about losing my money if I invest it.	22	23	22	31	2	=100
h. I just don't have enough money.	27	27	21	24	1	=100

THERE ARE NO QUESTIONS 3 AND 4.

5. What is your employment status? Are you self-employed, employed at a full time job, employed part time, unemployed, retired or a homemaker?

12	Self-employed (full or part time)
50	Employed full time
8	Employed part time
6	Unemployed
19	Retired
7	Homemaker
1	Disabled
*	Don't know

Total exceeds 100% due to multiple responses.

6. Are you now married, LIVING AS married, separated, divorced, widowed or have you NEVER been married?

56	Married
3	Living as married
2	Separated
12	Divorced
8	Widowed
18	Never married
1	Refused
100	

7. Is your (husband/wife/partner) self-employed, employed at a full time job, employed part time, unemployed, retired or a homemaker?

Based on respondents who are married or living as married; n=1052.

11	Self-employed (full or part time)
53	Employed full time
9	Employed part time
5	Unemployed
14	Retired
8	Homemaker
*	Disabled
1	Don't know

Total exceeds 100% due to multiple responses.

8. What is your age?

9	18-24
22	25-34
25	35-44
17	45-54
11	55-64
14	65+
2	Refused
100	

8a. At what age do you (and your husband/wife/partner both) plan to retire?

Based on respondents who are not retired; n=1451.

26	Younger than 60
24	60 to 64
21	65
4	66 to 69
11	70 or older
4	Never
10	Don't know
100	

9. Do you currently own your own home, do you rent, or do you have some other arrangement?

63	Own
30	Rent
7	Other arrangement
*	Don't know
100	

10. Do you plan to buy a home at some point?

11. When do you think you will buy a home?

Based on respondents who do not own a home; n=611.

69	Yes, plan to buy
14	Within the next year
30	Within 2-5 years
16	Within 6-10 years
6	More than 10 years from now
3	Don't know when
28	No, don't plan to buy
3	Don't know
100	

12. Do you have any children age 17 or younger?

13. How many?

14. How old is (this child/the oldest of these children)?

15. How old is the youngest?

37	Yes, have children 17 or younger
15	One
13	Two
9	Three or more
63	No children 17 or younger
*	Refused
100	

16. Do you think (your child/any of your children) will go to college?

Based on respondents who have children under 18; n=727.

86	Yes, at least one child will PROBABLY go to college
8	No
6	Don't know
100	

THERE IS NO QUESTION 17.

18. Over the next YEAR OR TWO, do you expect to have any MAJOR expenses for things like a new car, a special vacation, or a home improvement project?

45	Yes (include probably)
52	No
3	Don't know
100	

19. Over the next TWENTY years or so, do you expect to have any MAJOR expenses for helping a parent or other older relative with medical bills or living expenses?

28	Yes (include probably)
66	No
6	Don't know
100	

20. Now I want to ask about saving for (INSERT GOAL). Do you have any money saved or invested for (INSERT GOAL)?

Based on respondents who have each financial goal

	Yes	No	DK		n	% of Total Respondents who have this goal
Emergencies	68	31	1	=100	(1770)	100%
A down payment on a house	34	66	*	=100	(365)	22%
The major purchase you expect to make	52	46	2	=100	(821)	45%
Your child's/children's college education	56	43	1	=100	(635)	32%
Parent's or older relative's living or medical expenses	17	82	1	=100	(503)	28%
Retirement	64	35	1	=100	(1451)	80%

21. Do you have a specific PLAN or schedule for how OFTEN, how MUCH, and WHERE to save or invest your money for (INSERT GOAL)?

Based on respondents who are saving for each goal

	Yes	No	DK		n
Emergencies	57	42	1	=100	(1266)
A down payment on a house	44	55	1	=100	(140)
The major purchase you expect to make	62	36	2	=100	(456)
Your child's/children's college education	64	36	*	=100	(386)
Parent's or older relative's living or medical expenses	58	42	0	=100	(85)
Retirement	80	19	1	=100	(989)

21a. Do you feel you ALREADY should have started saving for (INSERT GOAL), or do you feel it's OK to start saving sometime in the future?

22. How do you feel about the progress you have made so far in saving for (INSERT GOAL)-- do you feel you are ahead, behind, or just about where you should be at this point?

Based on respondents who have each financial goal

	Ahead	Behind/ Should Have Started	About Right/ OK	DK		n
Emergencies	12	39	45	4	=100	(1770)
A down payment on a house	7	46	44	3	=100	(365)
The major purchase you expect to make	8	36	52	4	=100	(821)
Your child's/children's college education	10	45	42	3	=100	(635)
Parent's or older relative's living or medical expenses	5	32	53	10	=100	(503)
Retirement	13	38	47	2	=100	(1451)

23. Is the money you have saved or invested for (INSERT GOAL) in a SEPARATE account or investment, or is it MIXED in accounts or investments along with money you have set aside for other purposes?

Based on respondents who are saving for each goal.

	Separate Account/ Investments	Mixed With Other Money	Both	DK		n
Emergencies	51	38	9	2	=100	(1266)
A down payment on a house	41	52	6	1	=100	(140)
The major purchase you expect to make	40	53	5	2	=100	(456)
Your child's/children's college education	71	21	5	3	=100	(386)
Parent's or older relative's living or medical expenses	42	53	1	4	=100	(85)
Retirement	76	18	4	2	=100	(989)

24. Thinking about the total amount of money you have saved or invested for emergency expenses, about how many months of living expenses would this amount cover?

Based on respondents who have money saved for emergencies; n= 1266.

6	Less than one month
13	One to two months
27	Three to six months
8	Seven to nine months
38	Ten months or more
8	Don't know
100	

25. Do you (and your husband/wife/partner) have any money saved or invested that you use now or will use in the future to help support (yourself/yourselves) in retirement?

Based on retired respondents; n=319.

61	Yes
35	No
4	Don't know
100	

26. Have you ever calculated how much of your money you can withdraw each year from your savings and investments, and still expect your money to last over the rest of your lifetime?

Based on retired respondents who have money saved for retirement; n=211.

46	Yes
49	No
5	Don't know
100	

27. Do you have a specific PLAN for how much of your retirement money should be kept in different kinds of investments?

Based on retired respondents who have money saved for retirement; n=211.

43	Yes
51	No
6	Don't know
100	

28. Have you ever calculated how much money you (and your husband/wife/partner) will need in order to maintain your standard of living during retirement?

Based on respondents who are not retired; n=1451.

34	Yes
64	No
2	Don't know
100	

29. As far as you know, does (your employer) (or) (your husband's/wife's/partner's employer) offer any of the following types of retirement or pension plans?

Based on respondents who are employed or whose spouse is employed; n=1383.

	Yes	No	DK	
a. A 401-k plan?	55	38	7	=100
b. Any other pension plan where YOU can make direct contributions yourself?	36	58	6	=100
c. A pension or profit-sharing plan where your EMPLOYER makes ALL the contributions?	33	61	6	=100
d. An E-SOP or employee stock ownership plan?	20	74	6	=100

30. For each of the following ways to save for retirement, please tell me whether this is something you (and your husband/wife/partner) do EVERY year, SOME years, or not at all?

Items a and c are based on respondents who are not retired; n=1451, and item b is based on respondents who have a pension plan were they can make direct contributions; n=960.

	Every Year	Some Years	Not At All	DK	
a. Contribute money to an IRA account?	19	13	66	2	=100
b. Contribute to a 401-k plan or other employer pension plan?	66	6	27	1	=100
c. Set aside money for retirement in accounts or investments of your own?	31	13	54	2	=100

31. Who makes the decisions about how the money in the employer pension plan is invested– you (or your husband/wife/partner) or the employer?

Based on respondents who contribute to a pension plan or whose employer makes all contributions to a pension plan: n=860.

61	Respondent or spouse
32	Employer
5	Other
2	Don't know
100	

32. How confident are you that you are making the best choices for how to manage your money, savings and investments– very confident, somewhat confident, not too confident, or not confident at all?

Based on respondents who are savers; n=1533.

35	Very confident
49	Somewhat confident
10	Not too confident
4	Not confident at all
2	Don't know
100	

33. How would you rate your own knowledge about financial matters and about the way different types of investments work? Would you say your own knowledge about investments is excellent, good, only fair, or poor?

Based on respondents who are savers; n=1533.

8	Excellent
39	Good
43	Only fair
10	Poor
*	Don't know
100	

34. How often do you feel confused by what you read and hear about different kinds of investments-- often, sometimes, hardly ever, or never?

Based on respondents who are savers; n=1533.

25	Often
45	Sometimes
21	Hardly ever
8	Never
1	Don't know
100	

35. Who, if anyone, gives you advice about financial matters such as ways to save, retirement plans, or other investments?

Based on respondents who are savers; n=1533.

40	Any professional, e.g., banker, stockbroker, investment broker, accountant, insurance agent, financial planner, or financial advisor
31	Friend or family member
	Other
32	No one/make own decisions
1	Don't know

Total exceeds 100% due to multiple responses

36. Have you ever prepared a specific financial plan for yourself or had a professional prepare one for you? By financial plan, I mean a comprehensive document that includes investment funds, real estate and retirement plans, not a simple household budget.

Based on respondents who are savers; n=1533.

32	Yes
67	No
1	Don't know
100	

THERE ARE NO QUESTIONS 37 TO 39.

As I ask the next set of questions, please keep in mind that this is an OPINION survey about financial decision-making and investments. We are interested in what people know about all different kinds of investments, and you may not be familiar with some of the things I mention. Just respond as best you can. If you don't know an answer, just tell me and we'll move on to the next question.

40. **Over a period of time spanning the past thirty years, since the mid-sixties, which of the following types of investments do you think generally gave the HIGHEST RATE of return?**

Based on respondents who are savers; n=1533.

49	Stocks (* correct answer)
12	Bonds
12	Certificates of deposit
6	Treasury bills
21	Don't know
100	

41. As far as you know, which of the following investments has the GREATEST risk that you would lose some or all of your initial investment? Is it...

Based on respondents who are savers; n=1533.

66	Stocks*
3	Government bonds
12	A money market mutual fund
2	Treasury bills
17	Don't know
100	

42. Now, a question about saving for emergencies . . . as far as you know, about how many months of LIVING EXPENSES do financial professionals think should be kept in an emergency fund--

Based on respondents who are savers; n=1533.

6	One to two months of living expenses
35	Three to six*
10	Seven to nine, or
35	Ten to twelve months of living expenses?
14	Don't know
100	

43. In choosing an account or investment for an emergency fund, which of the following characteristics do YOU think is the MOST important characteristic for an emergency fund investment to have? Is it...

Based on respondents who are savers; n=1533.

17	The ability to earn interest TAX-FREE
13	The chance to make a HIGH RATE of return
45	The ability to get your money out QUICKLY*
15	The chance to earn steady DIVIDENDS or payments
10	Don't know
100	

44. As far as you know, in order to prepare for RETIREMENT, what percentage of income do financial professionals think is the MINIMUM a person should set aside each year? Is it...

Based on respondents who are savers and are not retired; n=1270.

5	At least two percent of income
24	At least five percent
40	At least ten percent,* or
17	At least twenty percent
14	Don't know
100	

45. How much money do financial professionals think most people will need AFTER they are retired in order to keep their standard of living about the same as it was BEFORE they retired? Will most people need

Based on respondents who are savers and are not retired; n=1270.

26	About 90 percent of their pre-retirement income
44	About 70 percent *
12	About 50 percent, or
5	About 40 percent in order to keep up their standard of living in retirement?
13	Don't know
100	

46. As far as you know, what do the experts recommend for people who are IN THEIR THIRTIES regarding how much of their RETIREMENT SAVINGS should be invested in stocks or stock mutual funds? Do they say that people in their thirties should have...

Based on respondents who are savers and are not retired; n=1270.

18	70 to 80 percent of retirement savings*
29	40 to 50 percent
27	10 to 20 percent, or
3	NONE of their retirement savings invested in stocks or stock mutual funds?
23	Don't know
100	

THERE IS NO QUESTION 47.

48. If you were choosing an investment for the money in a 401-k plan or IRA, which of the following would be the MOST important characteristic for that investment to have? Would it be...

Based on respondents who are savers and are not retired: n=1270.

21	The ability to earn interest or dividends tax free
17	A guarantee that you couldn't lose any money
12	The ability to get your money out quickly and without penalty
44	The chance to have your investment grow over a long period of time*
6	Don't know
100	

THERE IS NO QUESTION 49.

50. Now I'd like to know whether you are aware of the recommendations financial professionals make about how RETIRED people should INVEST the money they plan to live off during retirement. What do the experts recommend regarding how much of retired people's SAVINGS should be invested in stocks or stock mutual funds? Do they say that...

Based on respondents who are savers and retired; n=263.

2	ALL of their retirement savings
12	At least 75 percent
39	At least 20 percent, or*
8	NONE of their retirement savings should be invested in stocks or stock mutual funds?
39	Don't know
100	

THERE IS NO QUESTION 51.

52. In choosing an investment to help pay living expenses during retirement, which of the following characteristics do YOU think is the MOST important characteristic for an investment during retirement to have? Is it

Based on respondents who are savers and retired: n=263.

14 The ability to earn a high rate of return
24 A guarantee that the investment could never be lost
24 The ability to get your money out quickly and without penalty
26 The chance to get steady dividends or payments*
12 Don't know
100

53. As far as you know, what do financial professionals think is the MAXIMUM amount most retired people can withdraw from their savings each year if they want their savings to last for 30 more years? Should retired people withdraw

Based on respondents who are savers and retired; n=263.

11 About two percent
21 About five percent*
19 About 10 percent, or
7 About 20 percent of their savings each year?
42 Don't know
100

54. As far as you know, about how much does tuition, room and board cost for FOUR YEARS at a PRIVATE college today? Does it cost ABOUT...

Based on respondents who are savers and are sending a child to college; n=589.

6 $25,000 for four years
22 $40,000
33 $75,000 or about*
31 $150,000?
8 Don't know
100

55a. And, about how much does tuition, room and board cost for FOUR YEARS at a STATE college today? Does it cost ABOUT...

Based on respondents who are savers and are sending a child to college; n=589.

13	$15,000 for four years
31	$30,000*
29	$50,000 or about
17	$75,000?
10	Don't know
100	

55b. As far as you know, over the past twenty years, have college costs gone up MORE than the cost of living, LESS than the cost of living, or gone up about the SAME as the cost of living?

Based on respondents who are savers and are sending a child to college; n=589.

76	More*
4	Less
14	Same
6	Don't know
100	

56. Finally, I'd like to ask you just a few questions for statistical purposes only. I'll read a list of different accounts and investments. Please tell me which ones, if any, you (and your husband/wife/ partner) currently have. (IF YES TO Q30a OR b, ADD: Be sure to include the accounts for your IRA, 401-k or pension plan.)

Based on respondents who are savers; n=1533.

	Yes	No	DK	
a. A checking account	93	6	1	=100
b. A savings account	81	17	2	=100
c. A mutual fund account	40	57	3	=100
d. A certificate of deposit, or CD	30	68	2	=100
e. U.S. savings bonds	34	64	2	=100
f. An annuity	21	75	4	=100
g. A life insurance policy that includes savings	52	44	4	=100
h. U.S. Treasury bills	6	92	2	=100
i. Commodities, options, or other investment in the futures market	13	84	3	=100
j. Stocks in individual companies	39	59	2	=100
k. Real estate (OTHER than the house you live in)	25	74	1	=100
l. Any other type of investment	*	97	3	=100

57. Which of the following kinds of mutual funds do you (and your husband/wife/partner) currently own?

Based on respondents who have a mutual fund account; n=697.

	Yes	No	DK	
a. A money market mutual fund	50	43	7	=100
b. A stock mutual fund	62	31	7	=100
c. A government bond mutual fund	20	73	7	=100
d. A corporate bond mutual fund	18	74	8	=100
e. A balanced mutual fund that combines stocks and bonds	36	56	8	=100

58. Now I'd like you to tell me how you plan to use the money in (each of the/your) account(s) or investment(s you have)-- either for living expenses now, for emergency expenses that come up, (IF NOT RETIRED) for retirement, (IF HAS COLLEGE-BOUND CHILD) for your child's college education, or for some other purpose. (First,) how do you plan to use your...

Based on respondents who have each type of account.

	Living Expenses	Emerg. Expenses	Retire-ment	Colleges	Other Purposes	Combined Purposes	DK		n
a. checking account	78	2	1	*	1	16	2	=100	(1436)
b. savings account	14	42	6	2	10	23	3	=100	(1269)
c. mutual fund account (type not specified)	10	9	41	6	5	14	15	=100	(75)
d. money market mutual fund	7	12	43	4	15	16	3	=100	(362)
e. stock mutual fund	6	4	54	4	13	16	3	=100	(461)
f. government bond mutual fund	8	4	43	8	14	18	5	=100	(138)
g. corporate bond mutual fund	8	4	46	3	13	20	6	=100	(125)
h. balanced mutual fund	6	4	55	3	9	19	4	=100	(258)

Continued.

58. Continued...

	Living Expenses	Emerg. Expenses	Retire-ment	Colleges	Other Purposes	Combined Purposes	DK		n
i. certificate of deposit	6	16	26	5	20	17	10	=100	(465)
j. U.S. savings bonds	5	12	24	18	16	15	10	=100	(571)
k. annuity	11	6	48	2	12	12	9	=100	(334)
l. life insurance policy	7	17	30	2	23	11	10	=100	(810)
m. U.S. Treasury bills	6	6	38	7	13	17	13	=100	(127)
n. commodities, options, or other investment in the futures market	5	6	46	2	8	17	16	=100	(207)
o. stocks	7	7	42	3	13	21	7	=100	(695)
p. real estate equity	10	4	29	3	25	16	13	=100	(396)
q. other investments	16	0	38	0	39	7	0	=100	(8)

(READ) I'd like to get a GENERAL IDEA of the size of your savings and investments. Please keep in mind that this information is COMPLETELY confidential. and we need it only to get a statistical profile of investors.

59. First, about how much money altogether is invested in the company 401-k or pension plans that (you) (and) (your husband/wife/partner) have? Just stop me when I get to the right category.

Based on savers who have money invested in company 401-K or pension plan; n=886.

16	Less than $5.000
10	$5.000 to under $10.000
12	$10.000 to under $20.000
8	$20.000 to under $30,000
7	$30.000 to under $50.000
9	$50.000 to under $100,000
4	$100.000 to under $200.000
2	$200.000 to under $300,000
1	$300.000 to under $500.000
*	$500.000 to under a million dollars
*	A million dollars or more
31	Don't know
100	

60. Altogether. about how much money do you have in all your (other) various accounts and investments that we have been discussing — just stop me when I get to the right category.

Based on respondents who are savers; n=1488.

18	Less than $5.000
12	$5.000 to under $10,000
10	$10.000 to under $20.000
6	$20.000 to under $30.000
7	$30.000 to under $50,000
8	$50.000 to under $100,000
6	$100,000 to under $200,000
2	$200,000 to under $300.000
2	$300,000 to under $500.000
2	$500,000 to under a million dollars
1	A million dollars or more
26	Don't know
100	

61. Do you (or your husband/wife/partner) expect at some point to get an inheritance from a parent or other relative?

62. About how much money do you expect to inherit?

27 Yes
13 Less than $100.000
6 Between $100.000 and $500.000. or
2 More than $500.000
6 Don't know
68 No
5 Don't know
100

62a. When you retire. do you think you will sell your home and move to a different place, or do you think you will continue to live in the same place?

Based on respondents who own a home and are not retired; n=921.

35 Sell home and move
47 Live in the same place
3 Other/Depends
15 Don't know
100

62b. Do you expect that the mortgage on your home will be paid up by the time you retire, or not?

Based on respondents who own a home and are not retired; n=921.

82 Yes
14 No
4 Don't know
100

62c. Do you currently make any payments on a home mortgage or home equity loan, or not?

Based on respondents who are retired homeowners; n=238.

26 Yes
71 No
3 Don't know
100

62d. About what would you say is the value of the equity in your home? Just stop me when I get to the right category.

Based on respondents who are homeowners; n=1159.

5	Less than $5.000
7	$5.000 to under $10.000
7	$10.000 to under $20.000
8	$20.000 to under $30.000
11	$30.000 to under $50.000
23	$50.000 to under $100.000
14	$100.000 to under $200.000
4	$200.000 to under $300.000
1	$300.000 to under $500.000
1	$500.000 to under a million dollars
*	A million dollars or more
19	Don't know
100	

63. What is the last grade or class you completed in school?

9	Less than high school graduate (Grade 11 or lower)
31	High school graduate (including GED certificate)
4	Technical, trade, or business school after high school
24	Some college or university, but no 4-year degree
20	College or university graduate (BA, BS, or other 4-year degree received)
9	Post-graduate or professional schooling after college (including work towards an MA, MS, Ph.D., JD, DDS or MD)
3	Refused
100	

64. Are you of Hispanic or Latino descent, such as Mexican, Puerto Rican, Cuban, or some other Spanish background?

8	Yes
89	No
3	Don't know
100	

65. What is your race? Are you white, black, Asian, or some other race?

76	White
10	Black or African-American
2	Asian
8	Other or mixed race
4	Don't know
100	

66. How many adults age 18 or older, including yourself, live in your household?

30	One
53	Two
10	Three
4	Four or more
3	Refused
100	

67. Last year, that is in 1996, what was your total family income from all sources before taxes? Just stop me when I get to the right category.

8	Less than $10,000
10	$10,000 to under $20,000
12	$20,000 to under $30,000
13	$30,000 to under $40,000
14	$40,000 to under $60,000
13	$60,000 to under $100,000
6	$100,000 or more
24	Don't know
100	

68. In the next few months reporters from newspapers and magazines will be calling back SOME of the people who were interviewed as part of this survey. Would you be willing to discuss some of your answers in more depth with a reporter?

69. To help the reporters select people to re-interview, we will give them some brief background information about you. Also, so a reporter might reach you more easily, may I have your first name?

31	Yes
69	No/refused
100	

70. Respondent gender:

49	Male
51	Female
100	

U.S. Senate Committee on Finance
Hearing on Pension and Cash Balance Plan Issue

TO: Chairman Roth, Ranking Member Senator Moynihan, and members of the committee.

Thank you for including our written testimony (this letter) in the hearing record today (June 30, 1999). Our apologies for this delayed mailing, but we had planned to attend personally.

Our names are Thomas Jefferson French and Lynda Pauline French, husband/wife team. We are both employed at IBM Austin, Texas. Since our CEO came on-board with IBM, we have had our retirement funds drastically reduced twice in less than a five year span at a very critical late stage in our life. We are very confused and concerned for all U.S. workers and, of course, are quite devasted that U.S. mid-late career workers appear to have little protection against these forced hybrid pension reductions late in life. We are both dedicated and loyal employees of tenure: Tom French (age 49 and will have 25 years service August 1999 (so missed both the age 50 age clip and the 25 year service clip by 1 month/18 days!)) and Lynda French (age 54 years and 22+ years of service, making the age clip on this recent announcement).

Therefore, we were reduced less than 5 years ago by approximately 30-33% and now here comes the forced Cash-Balance conversion! The OAB (Opening Account Balance) is approximately 37.2% reduction for Tom on day #1 from the 1995 Amended Plan Defined Benefits (DB) retirement account. If we opt to take an annuity instead of the Cash-Balance lump sum at retirement, IBM has provided a so-called transition plan formula where reportedly you can you can take it only as an annutiy (rather than CB lump sum) and this great transition enhancer takes more than 6 years for the current value to reach the transition plan value! So, obviously, no benefit is really being offered, but IRS apparently approved this pathetic forced conversion that is devasting to many mid-late career employees that were given NO CHOICE! The so-called transition 'enhancement' to help the older workers to transition is simply worthless and has nothing to do with the benefits of our new Cash-Balance plan.

IBM has always provided propaganda that our wage is only about 50% of our total compensation (See attached "excerpts" from our 1989, 1991, and 1993 Compensation Booklets that were previously mailed to our homes -- last one came in 1993). Because employees did not contribute directly from their pay check to their retirement fund, then we all took IBM seriously that these retirement benefits were real dollars provided to us in lieu of additional wages and have always been a determining factor in considering a job opportunity with another company offering higher wages! Now, we learn that these benefits should have never been considered in our retirement planning at all — but IBM repetively encouraged us to do so our entire career!

Quite simply, at our ages and service tenure there is no way to recover what we have lost in the last 5 years. We plea to this committee to actively pursue prompt passage of pending legislation* such as S. 659 and HR 1176 and any/all new or pending legislation that can protect the mid-late career U.S. employees from such robbery! We have dutifully planned our retirement portfolio with investments in real estate, TDSP/401K, etc., but unfortunately our retirement core benefits and medical plans have been significantly impacted (beyond recovery) with this forced Cash-Balance conversion and termination of the prior medical plan - coupled with the 30-33% reduction in retirement wages in the 1995 Retirement Plan Amendments which reduced retirement and medical!

We would like to extend our thanks to all of those listed below that are currently co-sponsers of S. 659 (as follows) and plea to this committee to get 100% commitment to co-sponsorship of this bill and all future legislation in support of U.S. workers to prevent retirement theft late in life from these forced hybrid conversions.

A special thanks to the "Pension Rights To Know" (S. 659) sponsors and co-sponsors (listed below and any others we are not yet aware of):

- **Moynihan (D-VA)**
- **Robb (D-VA)**
- **Kerrey (D-NE)**
- **Chafee (R-RI)**
- **Schumer (D-NY)**
- **Leahy (D-VT)**
- **Wellstone (D-MN)**
- **Bingaman (D-NM)**
- **Johnson (D-SD)**
- **Rockefeller (D-WVA)**

In addition, we wish to thank all senators and congressman/women who are sponsors and co-sponsors of additional legislation on this topic such as Tom Harkin (D-IA) for the new "Harkin Legislation To Protect Retiree Pension Benefits" just announced June 24, 1999, which could curb cuts for the more aged "mid-late career" employees like ourselves by up to 50%, and etc.

We plea to all to consider getting current legislation to prevent this robbery passed quickly with retroactive dates upon passage such as S. 659 retroactive to March 17, 1999! Companies are pursuing in mass in an attempt to be grandfathered before pending and new legislation gets passed. PLEASE put retroactive compliance dates with all currently pending and new legislation on this matter before all the Fortune 500 companies push for quick approvals to rob the pensions of their older workers:

1. **Make all legislation with a retroactive date, such as the March 17, 1999 in S. 659 -- this will alleviate the problem of so many companies trying to rush these hybrid plans though without appropriate review and implementation planning in an attempt to get grandfathered before these hybrid plans have ample laws and rules for conversion guidance.**
2. **Stop IRS from approving all these hybrids until a thorough investigation is performed and current litigations are resolved and pending and new legislation is in-place.**
3. **Pass laws that would prevent the excess removal from plans for at least 5 years from hybrid conversion implementations - with audit criteria in-place required before "excess funds" can be removed! (this would cut down on the immediate greed reasoning for implementing such conversions).**
4. **Put constraints on International Companies that do U.S. only forced conversions! (U.S. workers appear to be the only ones in the world without sufficient government and state laws to protect them from this outrageously unfair clip implementation being implemented at IBM)**
5. **New laws to be retroactively applicable to all employees forced into a conversion since March 17, 1999 (be consistent in all proposed legislation with such a date as in S. 659 - let's stick with a date no later than the S. 659 March 17, 1999 date on all upcoming legislation)!**
6. **Expedite passage of S. 659 so that employers cannot continue to implement these "forced"**

hybrid conversions (NO CHOICE) plans without even disclosing the actual benefit cuts. Our Senate and Congress must change this. The refusal of IBM to give employees their tools to even calculate the reduction (tool ESTIMATR tools offline before the May 3rd, 1999 first notification change was coming). IBMers are now forced to spend alot of money to get actuarial, financial, legal assistance to interpret just because IBM refused to give the reduction information. This is almost as severe a crime as the implementation itself. Therefore, many employees may not realize their loss until they actually go to retire! This is simply an inexcusable non-caring implementation tactic and an insult to the integrity of the American workers! FULL DISCLOSURE is a minimum requirement and absolutely retroactive to at the latest of March 17, 1999!

We urge this committee and all legislators to act quickly and favorably on Sen. Moynihan's "Pension Rights To Know" (S. 659) and all other related pending and/or new proposals -- time is of essence before more baby boomers and U.S. workers life retirement plans are demolished and sacrificed late in life!

We have personally created a website to try to help U.S. workers that are being adversely affected by forced conversions late in life to better understand the plan differences and impact on their current retirement portfolio. How can one plan if the facts continue to be hidden from employees?

We requested and acquired the full trnscript of the Actuarial Tape where excerpts were shown on TV. That tells the story from those that are familiar with these hybrid plans — the gall to suggest coverup is the best answer! We don't need a U.S. full of baby boomers to find out at age 65 they have nothing left in their retirement buckets! The consultants implementing these deceiptful plans are a disgrace to our country and causing undue expenses to employer and employee alike by the coverup techniques being taught to employers!

The Cash-Balance and other hybrid plans implementation rationale to be beneficial due to new job wave (job hopping) and fund portability is only 'maybe' applicable to the younger worker who has time to plan on having little retirement and medical through their employer benefits. It is a hideous crime to force these hybrids without employee choice on the mid-late career employees, as we cannot readjust to compensate for the tremendous retirement and medical coverage for which we thought we had covered. We've been drilled and encouraged our entire career that our 'wage' is only about 50% of our total compensation and WE believed and planned around that fact our entire career!! It gives one a feeling of being mugged or robbed without cause -- especially when the current retirement accounts are self-supporting with multi-billion dollar excesses in many cases such as with IBM.

Please visit our webite "Got the 'Cash Pension Blues'?" where you can see the library of information we are attempting to collect and post to assist all U.S. workers. This is not just an IBM problem -- it is an America problem.

Our webite and email address can be found at: http://www.cashpensions.com

If you visit our website, please ensure you view a real eye opener of graphs showing the assumed loss as a NEW HIRE, 10 YEARS, 20 YEARS, and 24.9 YEARS (which is Tom French situation!) - a very pictorial eye opener.

6/27/99 7:26 PM

You may be interested in viewing the IBMPENSION or IBMUNION FORUMS at the Yahoo website that have also been formed by IBMers to discuss and try to understand why this forced conversation was allowed to occur with very little truthly guidance from their employer. If you visit these internet sites, you will readily learn that eventhough this letter is signed by merely two affected employees — our feelings and beliefs are heartfelt by many IBMers and U.S. workers across the country. So, please consider this letter as a global plea from the American workers!

Thank you very much for allowing us to present our letter for each of your consideration. We pray that immediate passage of laws will be handled favorably in an expedient manner. We only wish we could have been here personally to deliver our message.

Sincerely, Tom French Lynda P French

Tom and Lynda French
Austin, Texas
email: lynda@jump.net or webmaster@cashpensions.com
fax: 512-250-5249 (home fax#)
PS: If you would like our home # or address for further communication, please email or fax us and we will provide additional contact information.

ATTACHMENTS: (Excerpts from IBM compensation booklets)

Dear IBMer,

Since you received last year's Personal Benefits Statement, there have been significant changes in our medical and retirement plans. With these changes, IBM has advanced its leadership position in benefits while addressing cost in a responsible way. As a result, the company's benefits programs continue to be among the finest in American industry.

IBM's programs provide broad flexibility and are responsive to the changing needs of employees and the company. With your participation, they provide the basis for a healthy and secure financial future for you and your family.

This Personal Benefits Statement has been revised to reflect the value of the changes we have made. It is a key tool in understanding your benefits, and I urge you to use it as the basis for developing your personal financial plan.

John Akers

208

Dear IBMer, IBM continues to have a comprehensive benefits program that is one of the best in industry. Your 1989 Personal Benefits Statement demonstrates the value of these benefits to you.

Your benefits statement includes a summary of the major benefits coverage you received last year, the amount of protection that would be provided to your survivors and estimates of retirement income, Social Security and capital accumulation savings—all essential elements of planning your financial future.

We believe these benefits are a key aspect of IBM's belief in respect for the individual. I urge you to think about your financial goals, understand what the IBM benefits plans provide and decide what you need to do to assure a firm financial foundation for the future.

John Akers

07PLAD78R74S37 432161
T.J. French
12710 Red Deer Pass
Austin, TX 78729-6436

Personal Systems

Advanced Workstations and Systems
Entry Systems Technology
Fireworks Partners
IBM PC Company
Personal Software Products

1993

Total Compensation

Statement

IBM

James A. Cannavino
IBM Senior Vice President and
General Manager, Personal Systems

Dear PS Associate:

This is the first time you will have received your Personal Systems Total Compensation Statement. This booklet is an example of the many steps we have taken consistent with the continuing decentralization of IBM and the growing autonomy of Personal Systems.

Total compensation is more than the salary you receive. In addition to salary, it includes variable pay, which aligns earnings with business performance, as well as benefit programs that have a financial value. These benefits include: IBM's Retirement Plan, Tax Deferred Savings Plan, Employees Stock Purchase Plan, Medical and Dental Plans.

Based on 1992 business performance, the variable pay component provided additional earnings ranging from 0 to 4.2 percent of pensionable earnings. Your payment was based on the 1992 results of your business or the business you were directly supporting. The 1993 variable pay plan continues to be tied to business performance and has been expanded to potentially provide even greater earnings opportunity.

This Total Compensation Statement is a valuable tool in developing your personal financial planning strategies. Please review it carefully. If you have any questions about the statement, please contact your human resources representative.

As you are aware, our ability to maintain our highly competitive compensation and benefits programs continues to be tied to our financial success as a business. Thank you for your excellent work during these difficult times. I am counting on your continued efforts to help assure the success of Personal Systems and IBM.

Note:

All information about you in this Total Compensation Statement is as of December 31, 1992, if not otherwise stated. The benefits reported are based on your annual salary (or equivalent), which is referred to throughout as "annual salary." Most personal information is highlighted with yellow.

This Total Compensation Statement replaces the Personal Benefits Statement you have received in past years.

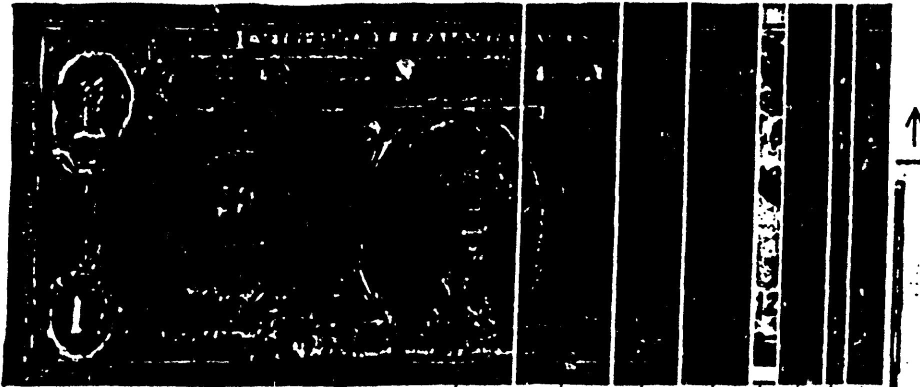
Personal Data Summary

07PLAD76R74S37 432161

T.J. French
12710 Red Deer Pass
Austin, TX 78729-6436

Date of Birth	**June 9, 1950**
Date of Hire	**August 19, 1974**
Serial Number	**432161**
Service with IBM	**18 years, 4 months**

Total Compensation



You have probably always thought of compensation in terms of annual salary. In reality, your *total compensation* is made up of many other components. In 1992, the value of these components was over $20,000 per employee. The remainder of this book is a report on various elements of total compensation that the company provides to you as an employee.

The newest element in total compensation is variable pay—that part of your earnings tied to the performance of your business unit.

07-016-0218
432161

Senator Bill Roth (Attn: Bill Sweetnam)
Senate Finance Committee
219 Dirksen
Senate Office Building
Washington, DC 20510

United States Committee on Finance
Hearing on Cash Balance Pension Plans and Other Pension Issues June 30, 1999

Chairman Roth, Ranking Member Senator Moynihan, and members of the Committee. Thank you for including my written testimony in the hearing record for today's hearing.

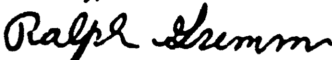
My name is Ralph Grimm. I am a 22-year employee of IBM from Longmont, Colorado. On July 1, 1999, my company will convert from its traditional defined benefit pension plan to a "cash balance" pension plan. As a result of this conversion, I will lose approximately 30% to 50% of the value of my pension, which will translate into approximately $150,000 - $250,000 of lifetime loss. I am able to provide only approximate loss calculations because IBM has refused to provide me with more specific information regarding the difference between the old plan and the cash balance plan.

For me, this is a very serious and demoralizing loss. I have two children who will be in college for the next 2-4 years. I was planning to retire at age 56 (with 30 years) and take care of aging parents, but still have the income needed to sustain our family. If I would have known about this plan change, I would have planned both my career and retirement savings differently. I will have to work an additional 10-12 years to recoup the losses. Had I known that the pension plan would be taken back (in mid stream, mid career), I would have worked for the highest bidder for the past 22 years. I have been a loyal, productive, and dedicated employee. Not giving mid career employees a choice to maintain the old plan is just plain wrong and immoral.

While I am losing this value, IBM has announced that it will save over $200 M from this pension change. Moreover, Lou Gerstner, the CEO received a salary and bonus of more than $22 M last year. IBM stock is at an all time high.

Current law allows companies to make these changes to employee pension plans without even disclosing the actual benefit cuts. Congress must change this. If only you could feel the sick feeling I have in the pit of my stomach when I think of all the years of IBM touting "Respect for the Individual" and all the hard work, overtime, which is about 38% this year, and heart I have put into my career. It is just not right that this can be taken from me without any recourse. I would never have stayed with IBM this long if I had known that the retirement plan would be so drastically reduced (and in such an underhanded and high pressure way). This is not fair. Employees deserve to know how they are being affected. I urge the Committee to act quickly and favorably on Senator Moynihan's bill, the Pension Right to Know Act (S. 659).

Sincerely,



Ralph Grimm
24 University Circle
Longmont, Colorado 80503-2236

STATEMENT OF THE INVESTMENT COMPANY INSTITUTE

The Investment Company Institute(1) is pleased to submit this statement to the Senate Committee on Finance regarding pension reform legislation issues raised at its June 30 hearing. Most importantly, we would like to take this opportunity to indicate our strong support for many of the provisions of S. 646, the "Retirement Saving Opportunity Act of 1999" and S. 741, the "Pension Coverage and Portability Act." Both bills would make the nation's retirement plan system significantly more responsive to the retirement savings needs of Americans. Both bills would encourage retirement savings by providing appropriate tax incentives to employers and individuals; and both would eliminate many of the unnecessary limitations that discourage small employers from establishing retirement plans and individuals from trying to save for retirement. The Institute commends the sponsors of S. 646 and S. 741 and other members of this committee for their interest in retirement savings policy.

Retirement savings are of vital importance to our nation's future. Although members of the "Baby Boom" generation are rapidly approaching their retirement years, studies strongly suggest that as a generation, they have not adequately saved for their retirement.(2) Additionally, 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, they must increase the portion of their retirement savings received through individual savings vehicles and employer-sponsored plans.

The Institute and mutual fund industry have 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) establish appropriate and effective retirement savings incentives; (2) enact saving proposals that reflect workforce trends and saving patterns; (3) reduce unnecessary and cumbersome regulatory burdens that deter employers—especially small employers—from offering retirement plans; and (4) keep the rules simple and easy to understand.

It is our view that together S. 646 and S. 741 achieve these objectives. The Institute previously expressed its strong support of the provisions contained in S. 646 at the Committee's hearing on increasing retirement savings on February 24, 1999. Therefore, this written testimony will focus primarily on the pension provisions contained in S. 741.

I. ESTABLISH APPROPRIATE AND EFFECTIVE INCENTIVES TO SAVE FOR RETIREMENT

A. Raise Low Caps That Unnecessarily Limit Retirement Savings.

In order to increase retirement savings, Congress must provide working Americans with the incentive to save and the means to achieve adequate retirement security. Current tax law, however, imposes numerous limitations on the amounts that individuals can save in retirement plans. Indeed, under current retirement plan caps, many individuals cannot save as much as they need to. One way to ease these limitations is for Congress to update the rules governing contribution limits to employer-sponsored plans and IRAs. Increasing these limits will facilitate greater retirement savings and help ensure that Americans will have adequate retirement income.

S. 741 contains several provisions that would address this issue, which the Institute strongly supports. Section 402 of the bill would increase 401(k) plan and 403(b) arrangement contribution limits to $12,000 from the current level of $10,000; government-sponsored 457 plan contribution limits would increase to $10,000 from the current level of $8,000. S. 646 would increase the 401(k) contribution limit to $15,000 and the 457 contribution limit to $12,000. Another important provision in both S. 741 and S. 646 would repeal the "25% of compensation" limitation on contributions to defined contribution plans. These limitations can prevent low and moderate-income individuals from saving sufficiently 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.)

S. 646 contains an additional proposal that the Institute urges Congress to enact. Specifically, Section 101 of S. 646 would increase the annual IRA and Roth IRA contribution limit to $5,000 and permit future adjustments to account for inflation. Today's $2,000 contribution limit was set in 1981—almost 20 years ago. If adjusted for inflation, this limit would be at about $5,000 today. IRAs are a critical component of the personal savings tier of the nation's three-tiered approach to retirement savings. But the current $2,000 contribution limit for IRAs no longer provides sufficient savings opportunities for many Americans in light of its loss of real value to

inflation over time, longer anticipated life expectancies and continuing increases in medical costs for our elderly population. Only the IRA is available to all working individuals, including those without access to an employer-sponsored plan. Raising the IRA contribution limit will provide all individuals with expanded retirement savings opportunities.

B. Simplify IRA Eligibility Rules And Bring Back The Universal Deductible IRA.

S. 646 would also simplify IRA eligibility criteria. As we explained in our testimony before this Committee on February 24, 1999, current eligibility rules are so complicated that even individuals eligible to make a deductible IRA contribution are deterred from doing so. When Congress imposed the current income-based eligibility criteria in 1986, IRA participation declined dramatically—even among those who remained eligible for the program. At the IRA's peak in 1986, contributions totaled approximately $38 billion and about 29% of all families with a head of household under age 65 had IRA accounts. Moreover, 75% of all IRA contributions were from families with annual incomes less than $50,000.(4) However, 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.(5) 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.(6) The number of IRA contributors with income of less than $25,000 dropped by 30% in that one year.(7) Fund group surveys show that even more than a decade later, individuals did not understand the eligibility criteria.(8)

Based on these data, the Institute recommends the repeal of the IRA's complex eligibility rules, as proposed in S. 646. These rules deter lower and moderate income individuals from participating in the program. A return to a "universal" IRA would result in increased savings by middle and lower-income Americans.

II. ENACT SAVINGS PROPOSALS THAT REFLECT WORKFORCE TRENDS AND SAVINGS PATTERNS

A. Make Retirement Account Balances Portable.

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 and 303 of S. 741, 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. This change in the law would make it easier for individuals to consolidate and manage their retirement savings.

B. Allow Individuals To "Catch-Up" When Able.

The laws governing pension plans also must be flexible enough to permit working Americans to make additional retirement contributions when they can afford to do so. 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 401 of S. 646 would address these concerns by permitting additional salary reduction "catch-up" contributions. The catch-up proposal in S. 646 would permit individuals at age 50 to increase their plan contributions by 50% over the otherwise permitted amounts. 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. S. 646 takes the additional step of exempting the catch-up contributions from nondiscrimination testing. We believe this is necessary to maximize the provision's effectiveness. Repeal of the "25% of compensation" limit, which is proposed in both S. 646 and S. 741, could further enhance the ability of Americans to "catch-up" on their retirement savings.

The "catch-up" is an excellent idea and is a sorely needed, practical response to the work and savings patterns of Americans today. We urge Congress to act on this proposal.

III. EXPAND RETIREMENT PLAN COVERAGE AMONG SMALL EMPLOYERS

A. Eliminate Unnecessary Regulatory Disincentives To Plan Formation.

The current regulatory structure applied to retirement plans contains many complicated and overlapping administrative and testing requirements that serve as a disincentive to employers, especially small employers, to sponsor retirement plans for their workers. Easing these burdens will promote greater retirement plan coverage and result in increased retirement savings.

Meaningful pension reform legislation must focus on the need to increase pension plan coverage among small businesses. Although these businesses employ millions of Americans, less than 20 percent of them provide a retirement plan for their employees. By comparison, about 84 percent of employers with 100 or more employees provide pension plans for their workforce.(9)

Unnecessarily complex and burdensome regulation continues to deter many small businesses from establishing and maintaining retirement plans. The "top-heavy rule" is one example of such unnecessary rules.(10) A 1996 U.S. Chamber of Commerce survey found that the top-heavy rule is the most significant regulatory impediment to small businesses establishing a retirement plan.(11) 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. While the Institute believes the top-heavy rule should be repealed, Section 104 of S. 741 would make significant changes to the rule, which would diminish its unfair impact on small employers.

B. Provide Incentives To Encourage Small Employers To Establish Plans.

In addition to eliminating rules that deter small businesses from establishing retirement plans, such employers also need appropriate tax incentives to encourage plan formation and address their unique economic concerns. There are two proposed tax incentives that we believe would effectively encourage plan formation among small employers.

First, Congress should provide a tax benefit that would reduce the start-up costs associated with establishing a pension plan. S. 741 proposes a tax credit for small employers of up to 50% of the start-up costs of establishing a plan up to $2,000 for the first credit year and $1,000 for each of the second and third year after the plan is established. S. 646 proposes a tax credit for small employers up to 50% of the start-up costs of establishing a plan up to $1,000 for the first credit year and $500 for each of the second and third year after the plan is established. Such a tax credit would encourage more small employers to establish retirement plans by diminishing initial costs.

Second, Congress should provide assistance to small employers who would like to contribute to a retirement plan for their employees in addition to offering them a salary deferral plan. Because many small employers have cash flow constraints, they are often reluctant to make a commitment to contribute to a retirement plan for their employees. Both S. 741 and S. 646 would grant small employers (those with up to 50 employees) a tax credit for 50 percent of their contributions (up to 3% of employee compensation) to a plan for non-highly compensated employees during the first 5 years of a plan's operation. This proposal is effectively designed to assure it helps those who need assistance the most—smaller employers and lower-paid individual employees—and would be an excellent way to help small employers deliver a meaningful retirement benefits to lower-paid employees.

C. Expand The Effective SIMPLE Plan Program.

The Institute also strongly supports expanding current retirement plans targeted at small employers. Specifically, the Institute supports expansion of the SIMPLE plan program, which was instituted in 1997 and offers small employers a truly simple, easy-to-administer retirement plan.

The SIMPLE program has been very successful. The Institute has found a continued pattern of strong small employer interest in SIMPLE plans over the program's two-year history. Indeed, new SIMPLE plan formation has continued unabated in the second year of its availability. Based on Institute estimates, mutual funds held in SIMPLE IRAs experienced tremendous growth in 1998, increasing from $0.3 billion to $1.6 billion.

Additionally, information gathered in informal Institute surveys of its members demonstrates just how popular this program is. For instance, one firm alone reported almost 10,000 SIMPLE plans and 47,000 SIMPLE accounts as of December 31, 1997. This increased by about 50 percent over the next quarter to about 14,000 plans and 72,000 accounts. By year-end 1998, the firm had an estimated 23,000

SIMPLE plans and 219,000 accounts. Thus, over one year the number of SIMPLE plans had more than doubled and the number of SIMPLE accounts had more than quadrupled. Other firms for which such data are available demonstrate similar growth rates. An Employee Benefit Research Institute study published in October 1998 similarly demonstrates the effectiveness of the SIMPLE, finding that 12% of small employers with a defined contribution plan report having established a SIMPLE plan over a period of less than 2 years. By comparison, only 9% of small employers surveyed sponsored a SEP, a program that has been available since 1979.(12)

Moreover, the SIMPLE plan has been especially popular with the nation's smallest employers. Institute surveys indicate that about 90% of those employers establishing SIMPLE plans had 10 or fewer employees. Employers with 25 or fewer employees constitute nearly the entire market.(13)

The success of the SIMPLE program is extremely significant, because the lack of retirement plan coverage in the small employer population has been stubbornly nonresponsive to previous policy initiatives and industry efforts. As noted above, 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.

Despite these successes, Congress can strengthen the SIMPLE program in two ways, each of which the Institute strongly supports. First, S. 741 would raise the SIMPLE plan contribution limits from $6,000 to $8,000 (S. 646 would increase the limit to $10,000). An increase in the SIMPLE plan contribution limit would assure that individuals who work for small employers will have opportunities to accumulate sufficient retirement savings. (As noted above, other provisions of the bills would increase the contribution limits for 401(k), 403(b) and 457 plans.) Second, S. 741 would provide for a salary-reduction-only SIMPLE plan. We believe that this would make the program much more effective for employers of 25-100 employees.

IV. SIMPLIFY UNNECESSARILY COMPLICATED RULES

Simplicity is the key to successful retirement savings programs. This is the lesson of the SIMPLE and IRA programs. S. 741 recognizes the need to keep the rules simple in the case of employer-sponsored plans. As we have noted above, complex and confusing rules diminish retirement plan formation and significantly reduce individual participation in retirement savings programs. We strongly support numerous provisions in S. 741 that would simplify rules. We discuss several of these provisions below.

First, S. 741 would provide a new automatic contribution trust nondiscrimination safe harbor. This safe harbor would simplify plan administration for employers electing to use it, enabling them to avoid costly, complex and burdensome testing procedures.(14) This provision is also an effective way to increase participation rates in 401(k) plans, especially the participation rates of non-highly compensated employees.

Second, the bill also would modify the anticutback rules under section 411(d)(6) of the Internal Revenue Code in order to permit plan sponsors to change the forms of distributions offered in their retirement plans. Specifically, the bill would permit employers to eliminate forms of distribution in a defined contribution plan if a single sum payment is available for the same or greater portion of the account balance as the form of distribution being eliminated. This proposed modification of the anticutback rule would make plan distributions easier to understand, reduce plan administrative costs and continue to adequately protect plan participants. In addition, S. 741 would permit account transfers between defined contribution plans where forms of distributions differ between the plans; this modification of the anticutback rule also would simplify plan administration. It also would enhance benefit portability, which, as noted above, is an important public policy objective.

Finally, S. 741 contains other provisions that would simplify currently burdensome rules and which the Institute supports, including repeal of the multiple use test.

V. CONCLUSION

Improving incentives to save by increasing contribution limits to retirement plans and IRAs will provide more opportunities for Americans to save effectively for retirement. Similarly, rules that accommodate the work and savings patterns of today will enable millions of Americans to save toward a secure future in their retirement years. Additionally, providing appropriately structured tax incentives, such as start-up and contribution tax credits for small employers, would increase plan formation. And finally, simplifying the rules applicable to employer-sponsored plans and IRAs

would result in a greater number of employer-sponsored plans, a higher rate of worker coverage and increased individual savings. The Institute strongly supports the provisions described above and commends the sponsors of S. 646 and S. 741 for supporting reforms of the pension system that will increase plan coverage and encourage Americans to save for their retirement. We encourage members of this Committee and Congress to enact this legislation this year.

ENDNOTES

(1) The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,576 open-end investment companies ("mutual funds"), 479 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $5.860 trillion, accounting for approximately 95% of total industry assets, and have over 73 million individual shareholders.

(2) For instance, one study concluded that 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 2014. By 2034, the Social Security trust funds will be depleted. 1999 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.

(4) 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).

(5) Internal Revenue Service, Statistics of Income.

(6) Venti, supra at note 4.

(7) Internal Revenue Service, Statistics of Income.

(8) For example, American Century Investments asked 534 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. Based on survey results, it was concluded that "changes in eligibility, contribution levels and tax deductibility have left a majority of retirement investors confused." "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).

(9) EBRI Databook on Employee Benefits (4th edition), Employee Benefit Research Institute (1997).

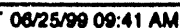
(10) The top-heavy rule is set forth at Section 416 of the Internal Revenue Code. The top-heavy rule looks at the total pool of assets in a plan to determine if too high a percentage (more than 60 percent) of those assets represent benefits for "key" employees. If so, the employer is required to (1) increase the benefits paid to non-key employees, and (2) accelerate the plan's vesting schedule. Small businesses are more likely to have individuals with ownership interests working at the company and in supervisory or officer positions, each of which are considered "key" employees, thereby exacerbating the impact of the rule.

(11) 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.

(12) Paul Yakoboski and Pamela Ostuw, "Small Employers and the Challenge of Sponsoring a Retirement Plan: Results of the 1998 Small Employer Retirement Survey," EBRI Issue Brief No. 202 (Employee Benefit Research Institute, October 1998).

(13) Institute informal survey results suggest that SIMPLE plan formation is negligible for employers of more than 25 employees.

(14) To qualify for the safe harbor, employers would need to make automatic elective contributions on behalf of at least 70% of non-highly compensated employees and match non-highly compensated employee contributions at a rate of 50% of contributions up to 5% or make a 2% contribution on behalf of each eligible employee.



Thomas Moe
06/25/99 09:41 AM

To: Senator Roth
cc:
From: Thomas Moe/Tucson/IBM@IBMUS
Subject: Cash-balance plans

Senator:

My company, IBM, has severely reduced my retirement benefits by converting my retirement plan from ERISA rules to the new Cash-Balance plan. As a result, after working for this company for 19 years and staying here through some very tough times, my thanks has been for IBM to say to me: SORRY SUCKER, I'M TAKING YOUR RETIREMENT MONEY.

I and millions of other people need your help now more than we have ever needed you in the past. The companies that are making these switches are lying and they are stealing! I earned that retirement money for the last 19 years. I don't have the last 19 years to work over again.

I have kids to put through college and I have saved for a long time for that. But with the new IBM cash-balance retirement plan, my medical plans have been gutted and I have no money in my retirement account. IBM has simply stolen the money they were supposed to have set aside for my retirement and told me to get lost. I estimate that I have lost 2/3 of retirement income, and that my medical plan expense account will be dry by the time I am 60-62; just in time for the Federal government to pick up the medical tab. IBM then skates away free and rich, and I have been a victim of wholesale theft.

Therefore, you must vote against companies that are just plain stealing from their employees and then lying about it.
There are two bills, S. 659 and HR 1176. I believe you should vote for them. Please see that my rights are protected from liars and greedy thieves.
I, and many others like me, need your help.

Thank you,

Thomas Moe
417 S. Many Winds Road
Benson, AZ 85602

STATEMENT OF MOORE PRODUCTS CO.

[SUBMITTED BY E.J. CURRY, EXECUTIVE VICE PRESIDENT]

Mr. Chairman and Members of the Committee:

Thank you for allowing me the opportunity to present my views for the record to the Committee on Finance as it examines the role of private employer pensions—which are so critical to America's workforce—and the need for reform.

My name is Edward J. Curry and I am the Executive Vice President and Chief Operating Officer of Moore Products, Co. Moore Products Co. is a global leader in providing manufacturers with innovative solutions to process measurement and control challenges. The Company's instruments and control systems help increase plant safety and productivity, reduce time to market, and improve quality in industries such as chemical, pharmaceutical, pulp and paper, oil and gas, and power. The Company's dimensional measurement systems facilitate inspection and quality control for discrete parts manufacturers in industries such as automotive and aeronautical. Founded in 1940, Moore Products, Co. has grown into an international operation with 120 representative offices worldwide. We are publicly traded on NASDAQ and our headquarters is located in Spring House, PA. Moore Products, Co., has 1200 employees and in 1998 reached $168 million in sales.

We are engineering and technology driven and are operating in a world of rapid technological change. Software is at the heart of this change and is now the core of the products that we manufacture. There is an intense competition for talent in this industry and it is thanks to talented engineers and software developers that Moore Products Co. has been able to maintain a competitive edge in the world. But to stay competitive, we must be able to attract and retain more of these highly skilled workers.

As an employer, we have a long history of sharing with our employees. Specifically, Moore Products, Co., offers competitive salaries; provides health care coverage that is 100 percent funded by the employer; offers a 401(k) savings plan and a defined benefit pension plan; and, offers a dental plan, a life insurance benefit, a disability plan, and an education plan.

We offer this benefit package in order to attract and retain the highest quality employees. The changing workforce, however, has different requirements and we as employers want to respond to those needs. For example, software engineers give us little credit for our defined benefit plan. Rather, they prefer equity in the company. Because these employees are essential for our continued success, we want to modify our benefits package to satisfy those demands. Specifically, we want to supplement the retirement benefits afforded through our defined benefit pension plan by enabling our employees to access the plan's excess assets under a program that our employees will better appreciate—a stock bonus plan. Unfortunately, we are unable to give our workers this additional benefit because the Tax Code currently imposes a prohibitively high tax on such transactions.

At present, we have a defined benefit plan with assets of $139 million. Our liabilities, as defined by the Pension Benefit Guaranty Corporation ("PBGC"), are only $66 million. That creates an excess of $73 million. We would like to unlock this overfunding and create a stock bonus plan whereby employees would be given clear title to these excess pension plan assets through equity in the company. Stock bonus plans make a company more competitive, create long term wealth for all employees, result in a more equitable distribution of wealth, and provide a strong connection between the employee and the success of the employer.

Under current law, however, we are unable to change the form of our pension benefits in this way because a transfer of excess assets from our defined benefit plan into a stock bonus plan would require us to terminate the pension plan and would be taxed as a reversion. Section 4980(a) of the Internal Revenue Code imposes an excise tax of 20 percent on the amount of assets reverting to the employer from a qualified plan. In addition, the excise tax increases to 50 percent unless the employer (a) transfers 25 percent of the excess assets to a qualified replacement plan or (b) provides benefit increases in the terminating plan equal to at least 20 percent of the excess assets. Such transactions also subject the employer to income tax on the amount of the surplus over 25 percent of the excess, whether or not it is transferred to the replacement plan. We have no desire to terminate our defined benefit pension plan. Further, the excise taxes, coupled with the gross income tax consequences—a combined total exceeding 85 percent—make a transfer of excess assets from our defined benefit plan into a stock bonus plan cost prohibitive, despite the fact that we wish to transfer all of the surplus on participants' behalf.

We therefore would support a proposal to amend the Tax Code to permit an employer to transfer excess assets under on ongoing defined benefit plan to a stock

bonus plan of the same employer. Under such a proposal, the amount of the defined benefit plan's surplus assets would be determined under ERISA rules relating to the valuation of plan assets and liabilities as if the plan had terminated. More importantly, however, under this proposal, the defined benefit plan would not need to be terminated, so participants' plan participation would remain unchanged.

Participants would be further protected in three ways: (1) an appropriate "cushion" amount, determined as a percentage of surplus assets, should be required to remain in the defined benefit plan; (2) all active employees under the plan would be fully vested in their accrued benefit, determined as of the transfer date; and (3) the proposal would require that the defined benefit plan could not be terminated before the end of the fifth plan year following the year of the transfer.

Under such a proposal, excess assets transferred to the stock bonus plan would not be included in gross income of the employer, would not be deductible by the employer, and would not be treated as an employer reversion under section 4980. By adopting this approach, the best features of both define benefit pension plans and stock bonus plans can be combined to enhance retirement security for workers while removing the prohibitive costs of such transfers.

We believe businesses that convert excess plan assets into another acceptable retirement vehicle should not fall under the rules in section 4980. We do not think changing the form of the retirement plan in which surplus assets are held should be characterized as a "reversion" because the employer would not be taking ownership of any of the retirement funds. Rather, the pension assets would continue to remain in a pension trust and participants' benefits would be enhanced and remain protected.

We believe that a proposal such as the one described above could be designed to expand benefit coverage as well as provide additional protection and security for employees in a number of ways. First, the stock bonus plan could be required to cover at least 95 percent of the active participants in the defined benefit plan who are employees of the employer immediately after the transfer date. Thus, virtually all of the active participants in the defined benefit plan would benefit from the surplus assets through participation in the stock bonus plan. Second, participants would be fully vested in the benefits under the stock bonus plan established with the excess assets. Further, the transferred surplus could be allocated as employer non-elective contributions—it would not be conditioned on any employee contribution. This enhances retirement security for lower- and moderate income workers. Finally, the transferred assets could be required to be allocated no less rapidly than ratably over the seven year period beginning with year of the transfer ensuring that the additional benefits are provided to workers in a timely manner.

The proposal would also encourage the continuation and maintenance of defined benefit pension plans by providing added flexibility for employers to create new retirement plans with surplus assets. Allowing employers this flexibility eliminates the disincentive associated with defined benefit plans that make it difficult to devote significant amounts of surplus assets to types of retirement benefits that the PBGC has found are more highly appreciated by employees. Moreover, the proposal specifically encourages employers to continue to maintain their defined benefit plans, rather than to terminate and then extract a reversion of the surplus assets.

In summary, the proposed change in the law would be highly protective of participants in defined benefit plans, would encourage the continued maintenance of such plans by employers, and would guarantee virtually universal coverage under the employer's new stock bonus plan to defined benefit plan participants so that they can benefit from their defined benefit plan's surplus.

We would encourage Congress to support rules that seek to protect defined benefit plan assets by discouraging reversions, and we support the growing move toward increased employee ownership. We view a proposal that adds flexibility to defined benefit pension plans and permits the movement of plan assets between retirement vehicles as consistent with the underlying spirit of both those goals. Our defined benefit plan is overfunded thanks to a long tradition of conservative funding practices because we share the belief that promised employee pension benefits should be protected. In addition, we are seeking to put those excess assets to a more productive use by transferring them into another retirement trust—a stock bonus plan—that demonstrates our commitment to the benefits of employee ownership.

The law should not penalize an employer for seeking to transfer a portion of surplus defined benefit plan assets for allocation to employees into another form of retirement plan that is more highly appreciated by the workforce and is encouraged by the Tax Code itself as a tool to attract and retain talented employees.

I would recommend that this Committee consider making a change to current law, along the lines of what we have described above, that would enable an employer like Moore Products Co. to respond to the needs of its workforce and allow the

transfer of excess defined benefit plan assets into a stock bonus plan to be accomplished without the imposition of income or excise taxes.

Thank you for your consideration.

STATEMENT OF THE NATIONAL ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS

[SUBMITTED BY MILAN P. YAGER]

I. INTRODUCTION

The National Association of Professional Employer Organizations (NAPEO) appreciates the opportunity to submit this statement for the record of the Committee's hearing on retirement and savings issues. NAPEO is the national trade association of the professional employer organization (PEO) industry. NAPEO represents nearly 600 member firms from start-ups to large, publicly traded companies. NAPEO members are found in all 50 states and employ the vast majority of worksite employees in PEO arrangements.

We applaud the Committee's interest in these issues and willingness to look at the tax code for ways to address our savings problem in this country, particularly our pending retirement savings crisis. It is our view that only through a partnership between the government and the private sector can this crisis be averted.

NAPEO's members would like to participate in that effort and in fact, we think that we are already doing so. That is because our members are in the business of expanding coverage and providing benefits to American workers. The professional employer organization or "PEO" assists mainly workers of small- and medium-size businesses. While the owners of these small and med-sized businesses focus on the "business of their business" PEOs assume the responsibilities and liabilities of the "business of employment." The PEO assumes responsibility for paying wages and employment taxes generally to all the workers of its client companies. It maintains employee records, handles employee complaints, and provides employment information to workers, such as an employee handbook.

Most significantly, the PEO provides to the workers of its customers retirement (usually a 401(k) plan), health, dental, life insurance, dependent care and other benefits, which for many of these workers is the first opportunity that they have had to obtain these benefits through their employment.

The average NAPEO member customer is a small business with just 18 workers and the average wage of these workers is around $20,000. These are truly small businesses with employees attempting to provide a working wage for themselves and their families. Unfortunately, because these workers are employees of small businesses, they are often left without the option of needed employee benefits.

A recent Dun & Bradstreet Corporation survey of businesses with fewer than 25 employees revealed that only 39% offered health care and just 19% offer retirement savings plans. PEOs, on the other hand, can provide benefits to these workers on a more affordable basis because they can aggregate the workers of all of their customers together into a larger group, thereby obtaining economies of scale that enable them to set up a qualified plan and purchase group health and other employee benefit plans. PEOs have the expertise to operate these plans in compliance with a rather complex set of requirements imposed by the tax code and ERISA.

An analyst at Alex. Brown & Sons estimates that 40% of companies in a PEO co-employment relationship upgrade their total employee benefits package as a result of the PEO relationship and further, that 25% of the companies upgrading their benefits are offering health care and other benefits to their workers for the first time.

A NAPEO survey of its members revealed that 98% offer health and dental insurance, 86% offer disability coverage, 80% offer vision care and 82% offer retirement savings plans.

Moreover, in some cases, workers co-employed by a PEO obtain the benefits of COBRA rights and the protection of other employment laws and regulations, only because they are included in the larger workforce of a PEO. By pooling employees of small businesses, PEOs bring workers under the protection of federal laws applicable to large employers such as HIPPA and the Family and Medical Leave Act. In addition, there is generally a higher rate of compliance with COBRA and other laws by a professional employer (PEO) than by its various clients. PEOs employ staff who are knowledgeable about these laws and regulations, and who are responsible for addressing employment concerns of worksite employees.

II. PROBLEMS WITH PRESENT LAW: AN OUTDATED TAX CODE

PEOs have found a need for these types of skills and benefits in the market place, as small- and medium-sized businesses have slowly but steadily sought out the services of PEOs over the past decade. The industry has expanded to meet this demand. At the state level, NAPEO sought recognition for PEOs and supported regulation, such as licensing, to ensure that the industry could grow.

At the Federal level, however, PEOs have been confronted with a tax code that was written long before the development of this industry. Therefore, the current rules for who can collect taxes and provide benefits do not neatly fit a PEO, its customer and workers. In fact, under some interpretations of the tax law, PEOs could not do the very things that small businesses want and need: collect employment taxes and provide retirement, health and other benefits.

Last year, Congressman Portman (R-OH) and Congressman Cardin (D-MD) attempted to address this problem by introducing H.R. 1891, which gained the support of 27 Members of this Committee. After its introduction, the sponsors and the industry met with other interested parties, including the Administration, who raised some specific concerns with the original bill. As a result, we went back to the drawing board to try to come up with an approach to our problem that was narrower, addressing the expressed concerns yet allowing us to do what we were already doing for small businesses and workers—providing benefits and collecting taxes.

III. REVISED PROPOSAL: CERTIFIED PEO STATUS

We are pleased to present to the Committee the fruits of those efforts—a revised proposal that continues to enjoy the support of our original sponsors, Mr. Portman and Mr. Cardin, and addresses the concerns raised by the Administration with the original proposal. This new proposal, unlike H.R. 1891, applies only to PEOs, not to temporary or other staffing firms. Thus, the proposal would not affect the litigation pending in the 9th Circuit, or any similar litigation. Nor does the proposal make any changes in the common law tests for who is an employee. In fact, the proposal specifically states this through the inclusion of a no-inference rule with respect to employment status.

In brief, what the new proposal does is to provide a safe harbor for PEOs who elect to meet certain requirements, which permits a PEO to assume liability for employment taxes with respect to worksite employees and to offer retirement and other benefits to such workers. In order to take advantage of this safe harbor, a PEO must be certified by the IRS. The certification requirements include a net worth test (if a PEO wants to have exclusive liability for employment taxes), and the submission of an annual audit by a CPA.

In order to prevent a customer from obtaining any better treatment under the tax code's nondiscrimination or other qualification rules under this proposal, a PEO's qualified plan would be tested under these rules on a customer-by-customer basis. A more detailed summary of the proposal is attached as an appendix.

IV. CONCLUSION: WORKERS GET THE BENEFITS THEY NEED AND DESERVE

Most importantly, this clarification of a PEOs' ability to offer retirement and health benefits permits the industry to continue to provide the workers of small and medium businesses with the benefits that they need and deserve. Current PEO customers can breathe a sigh of relief that the PEO plans in which their workers are currently participating will not be disqualified. PEOs can establish new plans under clear tax code rules. The market place's creative response to the difficulties of affording and providing benefits in a small business context can flourish without the uncertainty imposed by outdated tax rules. We believe this represents an ideal model of the public-private partnership that is needed to address the impending retirement savings crisis as well as the immediate health problem presented by our country's uninsured workers, and we urge its support by this Committee.

Overview of Proposed Certified Professional Employer Organization Legislation

July 9, 1999 Draft

I. Guiding Principles

- Difficulties in reaching conclusions regarding the highly factual determination of an "employee" and an "employer" should not limit the ability to provide workers with retirement, health, and other employee benefits.
- Clients of the CPEO and worksite employees should generally not get any significantly better or worse treatment under the nondiscrimination or other qualification rules than they would get outside of the CPEO arrangement.
- Employment tax administration should not be significantly affected by the use of a CPEO.

II. General Structure

If certain conditions are satisfied, an entity certified by the Internal Revenue Service as a Certified Professional Employer Organization (a "CPEO") will be allowed to elect (1) to take responsibility for employment taxes with respect to worksite employees of an unrelated client and (2) to provide such workers with employee benefits under a single employer plan maintained by the CPEO.

III. No Inference with Respect to Employment Status of Workers

The legislation will expressly state that it does not override the common law determination of an individual's employer. The legislation will not affect (and will explicitly state that it does not affect) the determination of who is a common law employer under federal tax laws or who is an employer under other provisions of law (including the characterization of an arrangement as a MEWA under ERISA), nor will status as a CPEO (or failure to be a CPEO) be a factor in determining employment status under current rules.

IV. Certification by IRS

In order to be certified as a CPEO under the legislation, an entity must demonstrate to the IRS by written application that it meets (or, if applicable, will meet) certain requirements. Generally, the requirements for certification will be developed by the IRS using requirements similar to the requirements for the ERO (electronic return originator) program and the requirements to practice before the IRS, as described in Circular 230, and will include review of the experience of the PEO and issuance of an opinion by a certified public accountant on the CPEO's financial statements. In addition, in order to be certified, a CPEO must represent that it (or the client) will maintain a qualified retirement plan for the benefit of 95% of worksite employees.

The CPEO must notify the IRS in writing of any change that affects the continuing accuracy of any representation made in the initial certification request. In addition, after initial certification, the CPEO must continue to file copies of its audited financial statements with the

IRS by the last day of the sixth month following the end of the fiscal year.

Procedures would be established for suspending or revoking CPEO status (similar to those under the ERO program). There would be a right to administrative appeal from an IRS denial, suspension, or revocation of certification.

V. Operation As a CPEO With Respect to Particular Workers

After certification, a CPEO will be allowed (1) to take responsibility for employment taxes for and (2) to provide employee benefits to "worksite employees". A worker who performs services at a client's worksite is a "worksite employee" if the worker and at least 85% of the individuals working at the worksite are subject to written service contracts that expressly provide that the CPEO will:

- Assume responsibility for payment of wages to the worker, without regard to the receipt or adequacy of payment from the client for such services;
- Assume responsibility for employment taxes with respect to the worker, without regard to the receipt of adequacy of payment from the client for such services;
- Assume responsibility for any worker benefits that may be required by the service contract, without regard to the receipt or adequacy of payment from the client for such services;
- Assume shared responsibility with the client for firing the worker and recruiting and hiring any new worker; and
- Maintain employee records.

For this purpose, a worksite would be defined as a physical location at which a worker generally performs service or, if there is no such location, the location from which the worker receives job assignments. Contiguous locations would be treated as a single physical location. Noncontiguous locations would generally be treated as separate worksites, except that each worksite within a reasonably proximate area would be required to satisfy the 85% test for the workers at that worksite.

The legislative history will indicate that the 85% rule is intended to describe the typical, non-abusive PEO arrangement whereby a business contracts with a PEO to take over substantially all its workers at a particular worksite, and that this 85% rule is intended to ensure that the benefits of the bill are not available in any situation in which a business uses a PEO arrangement to artificially divide its workforce.

VI. CPEO Employee Benefit Plans

A. CPEO May Maintain Employee Benefit Plans

To the extent consistent with the Internal Revenue Code and corresponding provisions of other federal laws, the CPEO may provide worksite employees with any type of retirement plan or welfare benefit plan that the client could provide. Worksite employees may not, however, be

offered a plan that the client would be prohibited from offering on its own. For example, state and local government workers may not be offered participation in section 401(k) plan. Similarly, a CPEO may not maintain a plan that it would be prohibited from offering on its own (e.g., a section 403(b) plan). However, an eligible client could maintain such plan.

In general, employee benefit provisions (in the Internal Revenue Code and in directly correlative provisions in other Federal laws) that reference the size of the employer or number of employees will generally be applied based on the size or number of employees and worksite employees of the CPEO. For example, worksite employees will be entitled to COBRA coverage. Similarly, a CPEO welfare benefit plan will be treated as a single employer plan for purposes of section 419A(f)(6). Plan reporting requirements are met at the CPEO level. However, a client which could meet the size requirements for eligibility for an MSA or a SIMPLE plan could contribute to such an arrangement maintained by the CPEO.

B. Nondiscrimination Testing

The nondiscrimination rules of the Code relating to employee benefit plans (including sections 401(a)(4), 401(a)(17), 401(a)(26), 401(k), 401(m), 410(b) and 416 and similar rules applicable to welfare and fringe benefit plans) will generally be applied on a client-by-client basis.

That portion of the CPEO plan covering worksite employees with respect to a client will be tested taking into account the worksite employees at a client location and all other nonexcludable employees of the client taking into account 414(b), (c), (m), (n) (with respect to workers not otherwise included as worksite employees) and (o), but one client's worksite employees would not be included in applying the nondiscrimination rules to portions of the CPEO plan covering worksite employees of other clients, to the portion of the plan including nonworksite employees, to other plans maintained by the CPEO or to other plans maintained by members of the CPEO's controlled group. Consequently, the CPEO workforce (other than worksite employees) will be treated as a separate employer for testing purposes (and will be included in applying the nondiscrimination rules to plans maintained by the CPEO or members of its controlled group). Thus, for example, in applying nondiscrimination rules to a plan maintained by the parent of a CPEO for employees of the parent and for employees who are not worksite employees of a client, worksite employees will not be taken into account.

For purposes of testing a particular client's portion of the plan under the rules above, general rules applicable to that client would apply as if the client maintained that portion of the plan. Thus, if the terms of the benefits available to the client's worksite employees satisfied the requirements of the section 401(k) testing safe harbor, then that client could take advantage of the safe harbor. Similarly, a client that meets the eligibility criteria for SIMPLE 401(k) would be allowed to utilize the SIMPLE rules to demonstrate compliance with the applicable nondiscrimination rules for that client.

Application of qualified plan and welfare benefit plan rules other than the nondiscrimination rules listed above will generally be determined as if the client and the CPEO are a single employer (consistent with the principle that the CPEO arrangement will not result in better or

worse treatment). Thus, there would be a single annual limit under section 415. Section 415 will provide that any cutbacks required as a result of the single annual limit will be made in the client plan. Deduction limits and funding requirements would apply at the CPEO level. In addition, if the client portion of a plan is part of a top heavy group, any required top heavy minimum contribution or benefit will generally need to be made by the CPEO plan.

The legislation will also contain language giving the IRS the authority to promulgate rules and regulations that streamline, to the extent possible, the application of certain requirements, the exchange of information between the client and the CPEO, and the reporting and record keeping obligations of the CPEO with respect to its employee benefit plans.

C. Service Crediting

There will be complete "crediting" of service for all benefit purposes. The break in service rules for plan vesting will be applied with respect to worksite employees using rules generally based on Code section 413.

Worksite employees will not generally be entitled to receive plan distributions of elective deferrals until the worker leaves the CPEO group. In cases where a client relationship terminates with a CPEO that maintains a plan, the CPEO will be able to "spin off" the former client's portion of the plan to a new or existing plan maintained by the client. Where the terminated client does not establish a plan or wishes to maintain the client's portion of the CPEO plan, the CPEO plan may distribute elective deferrals of worksite employees associated with a terminated client only in a direct rollover to an IRA designated by the worker. In the event that no such IRA is so designated before the second anniversary of the termination of the CPEO/client relationship, the assets attributable to a client's worksite employees may be distributed under the general plan terms (and law) that applies to a distribution upon a separation from service after that time.

D. Plan Qualification

The legislative history will provide that, similar to IRS practice in multiple employer plans, disqualification of the entire plan will occur if a nondiscrimination failure occurs with respect to worksite employees of a client and either that failure is not corrected under one of the IRS correction programs or that portion of the plan is not spun off and/or terminated. Existing government programs for correcting violations would be available to the CPEO for the plan and, in the case of nondiscrimination failures tested at the client level, to the client portion of the plan with the fee to be based on the size of the affected client's portion of the plan. Moreover, the CPEO plan will be treated as one plan for purposes of obtaining a determination letter.

E. Testing of Plans Maintained by Client

The legislation will treat any worksite employees as "per se" leased employees of the client, thus requiring clients to include all worksite employees in plan testing. In accordance with

current leased employee rules, the client will get credit for CPEO plan contributions or benefits made on behalf of worksite employees.

Consistent with this treatment of worksite employees, the client would be permitted to cover worksite employees under any employee benefit plan maintained by the client and compensation paid by the CPEO to worksite employees would be treated as paid by the client for purposes of applying applicable qualification tests.

F. Transition Issues

The legislation will direct the IRS to accommodate transfers of assets in existing plans maintained by a CPEO or CPEO clients into a new plan (or amended plan) meeting the requirements of the legislation (e.g., client-by-client nondiscrimination testing) without regard to whether or not such plans might fail the exclusive benefit rule because worksite employees might be considered common-law employees of the client.

VII. Employment Tax Liability

An entity that has been certified as a CPEO must accept liability for employment taxes with respect to wages it pays to worksite employees of clients. Such liability will be exclusive or primary, as provided below. The CPEO would be required to provide the IRS on an ongoing basis with a list of clients for which employment tax liability has been assumed and a list of the clients for whom it no longer has employment tax liability.

All reporting and other requirements that apply to an employer with respect to employment taxes apply to the CPEO for wage payments made by the CPEO. In addition, the remittance frequency of employment taxes will be determined with reference to collections and the liability of the CPEO.

Wages paid by the client during the calendar year prior to the assumption of employment tax liability would be counted towards the applicable FICA or FUTA tax wage base for the year in determining the employment tax liability of the CPEO (and vice versa). Exceptions to payments as wages or activities as employment, and thus to the required payment of employment taxes, are determined by reference to the client.

A CPEO will have exclusive liability for employment taxes with respect to wage payments made by the CPEO to worksite employees (including owners of the client who are worksite employees) if the CPEO meets the net worth requirement and, at least quarterly, an examination level attestation by an independent Certified Public Accountant attesting to the adequate and timely payment of federal employment taxes has been filed with the IRS.

The net worth requirement is satisfied if the CPEO's net worth (less goodwill and other intangibles) is, on the last day of the fiscal quarter preceding the date on which payment is due and on the last day of the fiscal quarter in which the payment is due, at least:

$50,000 if the number of worksite employees is fewer than 500
$100,000 if the number of worksite employees is 500 to 1,499
$150,000 if the number of worksite employees is 1,500 to 2,499
$200,000 if the number of worksite employees is 2,500 to 3,999
$250,000 if the number of worksite employees is more than 3,999.

In the alternative, the net worth requirement could be satisfied through a bond (for employment taxes up to the applicable net worth amount) similar to an appeal bond filed with the Tax Court by a taxpayer or by an insurance bond satisfying similar rules.

Within 60 days after the end of each fiscal quarter, the CPEO will provide the IRS with an examination level attestation from an independent certified public accountant that states that the accountant has found no material reason to question the CPEO's assertions with respect to the adequacy of federal employment tax payments for the fiscal quarter. In the event that such attestation is not provided on a timely basis, the CPEO will cease to have exclusive liability with respect to employment taxes (regardless of the net worth or bonding requirement) effective the due date for the attestation. Exclusive liability will not be restored until the first day of the quarter following two successive quarters for which an examination level attestations were timely filed.

In addition, the Secretary will have the authority, under final regulations, to provide limits on a CPEO's exclusive liability for employment taxes with respect to a particular customer in cases where there is an undue and large risk with respect to the ultimate collection of those taxes.

For any tax period for which any of these criteria for exclusive liability for employment taxes are not satisfied, or to the extent the client has not made adequate payments to the CPEO for the payment of wages, taxes, and benefits, the CPEO will have primary liability and the client will have secondary liability for employment taxes.

VIII. Effective Date

These provisions will be effective on January 1, 2001 or, if later, 12 months after the date of enactment. The statute will direct the IRS to establish the PEO certification program at least three months prior to the effective date.

PENSION RIGHTS CENTER

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IBM EMPLOYEES CONVERGE ON WASHINGTON TO DEMAND PENSION JUSTICE

On the eve of the announced dramatic restructuring of IBM's pension plan, company employees from throughout the country are descending on the nation's capital to implore IBM not to go through with ditching their plan for older workers. IBM employees are holding a press briefing on **Wednesday June 30th at the "Senate Swamp," (on the Capitol lawn on the Senate side) at 11:30 a.m.** to urge Congress to stop companies from breaking their pension promises and to ask IBM to hold off on their proposed plan change. **In the event of rain, the press event will be moved to 342 Dirksen Senate Office Building.**

The IBM employees, mostly mid-career employees in their forties, became unlikely activists when they heard that IBM was planning to switch the plan they'd been under throughout their careers to a new form of pension called a "cash balance plan." In essence, this move would rob many older workers of benefits they were expecting, reducing their anticipated pensions in some cases by as much as 50 percent.

"Cash balance plans are a clever cost-cutting maneuver that translate into pay cuts for older employees," says Karen Ferguson, director of the Pension Rights Center, "IBM is saving millions of dollars a year at the expense of long-time employees who built the company. IBM is changing the rules of the game midstream. This is fundamentally unfair."

-More-

The IBM employees, who ironically have used their computer expertise to organize themselves on the internet against the company's unfair pension policies, are also in town to attend a Senate Finance Committee hearing on cash balance plans earlier in the morning. The employees are intent not only on changing company policy but also in ensuring that other corporations are stopped from breaking pension promises. Three hundred corporations in the United States -- including Aetna, CBS, RJR Nabisco and Safeway -- have already converted to cash balance plans. However, some of these companies have given their employees a choice to stay under the old plan.

#30

STATEMENT BY THE PRINCIPAL FINANCIAL GROUP
TO
COMMITTEE ON FINANCE
U.S. SENATE
ON
PENSION REFORM LEGISLATION
June 30, 1999

This statement is submitted by The Principal Financial Group, a family of insurance and financial services with over $82 billion in assets under management. Its largest member company, Principal Life Insurance Company, is currently the eighth largest life insurance company in the nation based on 1997 assets. The Principal Financial Group provides retirement plan investment and administrative services to more than 43,000 employers, the majority of whom employ fewer than 100 employees.

The Principal appreciates the opportunity to comment on retirement security and pension reform. In recent years, Congress has strengthened the employer-sponsored retirement system and improved the retirement security of many American workers. In particular, the pension simplification provisions enacted by the Small Business Job Protection Act of 1996 (Public Law 104-18) and the Taxpayer Relief Act of 1997 (Public Law 105-34) have helped ease plan administration and helped more small employers establish retirement plans for their employees. Nevertheless, the Principal believes more can, and should, be done to encourage employers to establish and maintain retirement plans. The Pension Coverage and Portability Act (S. 741) introduced by Senators Graham and Grassley and the Retirement Savings Opportunity Act (S. 646) introduced by Senators Roth and Baucus will help achieve these goals.

The passage of provisions in S. 741 and S. 646 will help the U.S. private pension system by:

- Encouraging more private pension plans to be formed,
- Allowing U.S. workers to contribute more to their retirement plans,
- Simplifying existing overly complex rules,
- Making it easier to preserve plan assets for retirement, and
- Addressing women's pension equity issues.

We offer the following comments on the provisions in S. 741 and S. 646:

Retirement Plan Limits

The Principal supports the proposed increases in the various dollar limits. Increases in the dollar limits will encourage employers to establish plans by allowing them to accumulate benefits in an amount comparable to the amounts accumulated by lower paid employees. S. 741 increases the defined benefit 415 dollar limit, the compensation limit, the elective deferral limit and the SIMPLE plan elective deferral limits; it does not, however, increase the defined contribution 415 dollar limit. We urge you to increase this limit, as well, since existing non-discrimination rules—such as the 401(k)/(m) nondiscrimination tests and the compensation limit—will ensure that plans do not discriminate in favor of the highly compensated employees.

We also support repealing the 25 percent of pay limit on annual additions under a defined contribution plan. This limit has little effect on the most highly paid employees while adversely affecting lower paid employees who choose to contribute generously to their 401(k) plans. Repealing the percent of pay limit would allow lower paid employees to increase their retirement savings.

Administrative Costs

We are pleased S. 741 includes provisions to reduce administrative costs and burdens which have a disproportionate impact on small employers. Specifically, allowing matching contributions to be counted toward satisfying the top-heavy minimum required contribution and modifying the definition of key employee will help small employers comply with these rules. Elimination of the multiple use test for 401(k)/(m) plans will also simplify the nondiscrimination test and reduce the administration burden on plan sponsors. We also strongly support provisions that promote good faith compliance and correction of plan errors rather than plan disqualification and IRS sanctions. We urge the Committee to support this feature as it will encourage self-correction without penalizing inadvertent violations of the qualified plan rules.

Portability

We are particularly pleased with the liberalization of the transfer and rollover rules and the modification of the same desk rule for 401(k) plans. Corporate acquisitions, mergers, dispositions and voluntary job changes are increasingly frequent today; these incidents can have a huge impact on an employee's retirement savings. As employees change jobs, keeping track of their retirement accounts from several different plans is difficult and time consuming. The best way to do this is to make it easier for employees to transfer these distributions to qualified plans or roll them over to an IRA. The provisions in S. 741 will preserve plan assets by making it easier to transfer benefits between 401(a), 403(b) and 457 plans. The bill also eliminates the "same desk rule" that prevents employees in 401(k) plans from receiving a distribution in certain corporate take-over situations.

Participant Security

The Principal supports requiring faster vesting of employer matching contributions and allowing members age 50 or older to make additional contributions of up to $7,500 per year to 401(k), 403(b), 457 and SIMPLE plans. We also support provisions that would require defined contribution plan members to receive annual benefit statements and defined benefit plan participants to receive benefit statements every three years.

Tax Credit for Small Employers

We support the tax credit for small employers to offset the costs of setting up and administering a new plan. Many employers feel the costs associated with running a retirement plan prohibits them from establishing a plan. This is especially true for small employers whose decision to sponsor a plan is impacted by the cost of the plan. This tax credit will help offset the cost of establishing a retirement plan and will encourage more small employers to set up a plan.

Highly Compensated Employee

We oppose the provision that would eliminate the employer's option to count only the top-paid 20 percent of employees who earn more than $80,000 when determining the number of employees who

are considered to be highly compensated employees. While most employers are not affected by this option, there is a small percentage of businesses that have a large proportion of their workforce earning more than $80,000. These businesses include computer programmers, engineers, and sales representatives whose bonus income push them over the earnings limit. This option should be preserved.

Defined Benefit Plans

S. 741 encourages employers to establish and maintain defined benefit plans by creating a simplified defined benefit plan. The Secure Assets for Employees (SAFE) plan will reduce existing administrative costs and hassles that make defined benefit plans unattractive to many employers.

Cash Balance Plan Disclosure

There has been much discussion on the issue of participant disclosure when a traditional defined benefit plan sponsor converts its plan to a cash balance defined benefit plan. H.R. 1102 requires a plan to provide plan members with an ERISA 204(h) notice at least 30 days before the amendment effective date. The bill also stipulates that plan members be given a copy of the plan amendment or a summary of the amendment as well as a description of the reduction in benefits. Some members of Congress believe the 204(h) notice requirements should be expanded even further. The Pension Right to Know Act (S. 659) introduced by Senator Moynihan, would require plan sponsors to provide numerous illustrations to each participant outlining the participant's benefit under the old and new formulas.

Cash balance defined benefit plans are becoming popular as employers want to have a plan that is more attractive to and more easily understood and appreciated by today's mobile workforce. For these employers, converting to a cash balance plan may make some sense. However, the Principal agrees that additional disclosure to plan participants is necessary. We do not believe the provisions included in S. 659 are the right approach. Instead, we support a middle of the road approach on cash balance disclosure. That is, any conversions should come with a disclosure of before and after benefits illustrations for four or five typical age and service groups. Individualized comparisons would be available upon request. We believe such requests for additional information should be limited to two requests within the 12 month period following the date of the conversion.

Summary

The Principal believes that more small employers will establish retirement plans if we can make those plans more attractive for the employer and his/her highly compensated employees. We should educate plan sponsors about the types of plans that are available, provide incentives— such as tax credits for start-up costs and increased dollar limits—for employers to establish such plans, and then make plan administration less costly and less time consuming. The provisions in S. 741 will accomplish much of this. We strongly urge Congress to enact these provisions this year.

For More Information

Questions or comments may be directed to either of the following employees of The Principal:

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Retired Public Employees Association, Inc

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Cynthia Wilson, President
John K. Muth, Executive Direc

Statement of Cynthia Wilson, President
Retired Public Employees Association of N.Y.S.
435 New Karner Road
Albany, New York 12205

Written Statement for the Senate Finance Committee
Hearing on Pension Reform Legislation
Wednesday, June 30, 1999

I am writing as President of the Retired Public Employees Association, a not-for-profit member-supported organization of more than 80,000 members who are retirees from New York State Government and from local governments, plus their spouses. A large number of our members belong to the New York State Deferred Compensation Plan, organized under Section 457 of the IRS Code.

Our concerns are these:

1. Under the current 457 Plan, members have only one opportunity to select their desired timing for distribution of their assets. That must be done within 120 days after retirement. Once that decision has been made, it is irrevocable, except for the option of a one-time postponement. Since many members retire well before age 65, this type of constraint upon their distribution option makes rational financial planning virtually an impossibility. Therefore, many members withdraw their funds prematurely in fear that they will not be able to make future withdrawals if emergencies should arise.

2. Members are severely restricted in their investment choices when compared to provisions offered by an IRA. Similarly, they do not have the option of selecting a financial agent whom they judge to be more service-oriented and/or more cost-effective.

3. Participation in the N.Y.S. Deferred Compensation Plan by eligible employees is only about 27 percent. If potential participants knew they would be able to roll-over their assets into an IRA after retirement, the 457 Plan would be much more attractive to public employees and would therefore result in greater participation in the 457 Plan.

In summary: We recommend that necessary modifications be made to Section 457 of the IRS Code to allow roll-over to IRAs at the time of retirement. Resulting benefits would include:

- Much greater flexibility in timing and amount of withdrawals,
- Continued tax deferral of undistributed balances,
- Vastly increased investment choices,
- Elimination of sponsor fees,
- Freedom to change investment agent if poor performance occurs, and
- Increased participation in the Deferred Compensation Plan.

Thank you for this opportunity to submit a statement for inclusion in the hearing record.

••••

Statement of
Jim McCarthy, Merrill Lynch & Co., Inc.
on behalf of the Savings Coalition of America

Before the
UNITED STATES SENATE
COMMITTEE ON FINANCE

June 30, 1999

This statement is presented on behalf of the Savings Coalition of America -- a broad-based group of parties interested in increasing personal savings in the United States. The 75 member organizations of the Savings Coalition represent a wide variety of private sector organizations including consumer, education and business groups; senior citizen groups; home builders and realtors; health care providers; engineering organizations; and trust companies, banks, insurance companies, securities firms, and other financial institutions. A list of the members of the Savings Coalition is attached.

On behalf of Merrill Lynch and all of the other members of the Savings Coalition of America, let me begin by commending the Finance Committee for holding this hearing today. Savings, and particularly retirement savings, is the key to America's long-term economic prosperity.

With Americans saving less than at any time since World War II, we stand at a crossroads. For individuals (including especially the baby boom generation), inadequate savings today will lead to a retirement crisis in the next century. If Americans do not begin saving more for retirement soon, the pressures on the Social Security system that are caused by the aging of our population will be compounded. With Americans living longer, millions of Americans will face prolonged retirements without the financial wherewithal to meet day-to-day needs. Moreover, if low savings rates continue at the national level, they will, over time, lead to higher interest rates and slower economic growth -- further increasing the difficulty of dealing with the problems raised by the changing demographics of our population. For these and many other reasons, doing something now to enhance retirement savings is critical.

Traditionally, retirement security for Americans has been based on the so-called "three-legged stool" -- Social Security, employer-sponsored retirement plans and personal savings. Dealing with our nation's ongoing savings shortfall effectively will require that each of those legs be strengthened. In particular, Congress should not ignore the critical personal savings leg of the three-legged stool and the Individual Retirement Account, or IRA, has proven over the last 25 years to be the most effective method for focusing personal savings.

The members of the Savings Coalition ask the members of this Committee to enact the provisions of S. 646 -- the Retirement Savings Opportunity Act of 1999, introduced by Senators Roth and Baucus. Among other important changes, that legislation would substantially expand personal savings by increasing the maximum permitted IRA contribution from $2,000 to $5,000,

eliminating the complex and counterproductive income limits on IRA participation, and allowing additional catch-up contributions to IRAs for those approaching retirement.

IRAs and Roth IRAs Work

Before going into the provisions of S. 646 in more detail, let me congratulate the members of this committee, and in particular Chairman Roth and Senator Breaux, for beginning the process of bringing the Individual Retirement Account "out of retirement" in 1997. Our experience at Merrill Lynch indicates that the new Roth IRA could well be the most effective new savings generator since the successful expansion of section 401(k) plans in the 80s and early 90s.

One need go no further than the advertisements in the newspapers and other media to see that the Roth IRA changes that Congress enacted in 1997 have revitalized America's interest in the IRA. With expanded advertising, more and more people have begun asking questions about the new savings options available to them. In the process, they are becoming better educated about the importance of saving for retirement. For many, there has been a growing awareness of how far behind they are in saving for a financially secure retirement.

Although it is still early, our Financial Consultants tell us that many of our customers are responding to the pro-savings message that the Roth IRA sends. Significantly, they are increasing their savings not only through Roth IRAs, but also through traditional IRAs and other savings vehicles.

As with any new financial product, consumer interest builds over time. But under almost any reasonable measure, the Roth IRA has been a tremendous success. Industry-wide statistics are not yet available for 1998, the first year that the Taxpayer Relief Act of 1997 IRA changes went into effect, but preliminary results at Merrill Lynch show an unprecedented increase in IRA activity. Through December 1998, we have seen an increase of more than 80 percent in the number of total IRA contributions over the same period in 1997 -- an astounding increase for a new savings vehicle. This includes new Roth IRAs and increased contributions to traditional IRAs. And we can expect contributions for 1999 and beyond to increase even more as consumer awareness grows, just as IRA contributions grew steadily between 1982 (the first year IRAs became universally available) and 1986 (when IRA access was severely restricted).

One interesting aspect of the Roth IRA expansion is that we have seen considerable spillover savings resulting from the Roth IRA advertising. For example, we have experienced a sizable increase in traditional deductible IRA contributions. To some extent that increase is attributable to the changes that were enacted in 1997 expanding the availability of deductible IRAs. However, we have seen people who were always eligible for deductible IRAs come back because they did not realize they were eligible in the past. They have called to ask about the Roth IRA, but have decided to contribute to a traditional IRA or another savings vehicle. The Roth IRA legislation deserves the credit for putting those people back in the savings habit.

To illustrate how big a success the Roth IRA and other 1997 Act IRA changes have been. one need only compare the early stages of today's developing IRA market with the early stages of other new savings vehicles created by Congress -- including earlier versions of the IRA. Once again, we won't have complete statistics for quite some time, but when you compare the IRA activity we have seen in 1998 with our early experience with other products, the success of the 1997 IRA changes becomes clear.

In calendar year 1998, Merrill Lynch established more than two and one half times more new IRAs than we established during the same period in 1982, the first year of universal IRA eligibility. This despite the fact that the IRA available in 1982 was simpler, available on a fully-deductible basis to most Americans, and more tax-advantaged (due to higher marginal income tax rates that were in effect in 1982). Additionally, with the ongoing popularity of the 401(k) plan, the Roth IRA has succeeded in the face of a variety of other alternative choice's. Similarly, the new Roth IRA has been extremely well received when compared with other recently introduced tax vehicles. In 1998, for example, Merrill Lynch established one hundred times more Roth IRAs than Medical Savings Accounts.

These recent developments, confirm what we already knew from earlier experience, the IRA works at increasing individual savings. The IRA has proven time and again to be the single most effective vehicle for encouraging personal retirement savings by Americans.

NEED FOR MORE CHANGE

Despite the initial success of the changes enacted in 1997, there is no question that current savings incentives will not be sufficient to reverse America's serious savings shortfall. The 1997 Act IRA changes were important steps in beginning the process of improving the incentives to save. But more change is needed.

Since the 1970s the U.S. personal savings rate has declined steadily. During the 1960s and 70s, our national savings rate averaged around 8% per year. In the last half of the 80s, it dropped to about 5.5% and in the 90s it has dropped to a 3.6% annual average. Last year, the savings rate was an anemic ½ of 1 percent, the lowest level since the Great Depression of the 1930s.

It is the baby boom generation that is in the most danger. Research by Stanford University economist Douglas Bernheim, who compiles an annual Baby Boom Retirement Index for Merrill Lynch, has consistently shown that the baby boom generation has fallen as much as two-thirds behind the rate of savings that they need to maintain their current standard of living in retirement. It is our responsibility to help the baby boom generation (and future generations) to start saving more. If we do not accomplish that goal soon, the financial burden that will be placed on our Social Security system, our economy, and ultimately our children and grandchildren, in the next millennium could be disastrous.

While there are many causes for our national savings shortfall, one of the main reasons is that our tax system continues to penalize savings and investment. What became known as the Roth IRA was an innovative step to correct that imbalance. The additional proposals made in S. 646, are the next logical steps toward providing every American with a meaningful opportunity to save for a secure retirement.

Let me highlight a few of the changes proposed in the S. 646 that we believe would have the most beneficial impact.

WHY 2K?

The current $2,000 maximum IRA contribution has been in place since 1981. S. 646 would increase the maximum IRA contribution to $5,000 for both Roth and traditional IRAs (and would index that limit for future inflation). That change is long overdue -- almost 20 years overdue. The limit on IRA contributions has been stuck at $2,000 since 1981. If the IRA contribution limit had been adjusted for inflation since IRAs were created in 1974, Americans could now contribute about $5,000 per year to an IRA. Of all retirement savings plans, only the IRA limit has never been indexed for inflation.

As things stand today, the maximum IRA contribution is not adequate to meet the growing retirement needs of Americans. Future retirees can look forward to longer life expectancies and more years in retirement. When combined with continuing inflation in medical costs (which are especially important for those in retirement) and the long range financial challenges facing the Social Security Trust Fund, it becomes clear that the need for a significant personal savings component in retirement is becoming even more critical than it was in the past. A two-legged. stool consisting of Social Security and employment-based retirement plans, cannot be expected to meet the increasing need. Also, for many of the more than 50 million workers who are not covered by an employment-based retirement plan, IRAs may be the only retirement savings opportunity.

Interestingly, we have found that more than 90% of our customers contributing to an IRA fund it at the annual $2,000 maximum. They save the maximum amount permitted and commit that amount to long-term retirement savings. With higher contribution limits, we fully expect that many of those individuals will save more.

Even for those who do not contribute the maximum in every year, the higher contribution limit will allow flexibility to make IRA contributions in the years that they have the resources to make the contributions. For example, a family where one spouse remains at home to care for children will often not have disposable income for large IRA contributions. When the children are older, however, the couple may be better able to make IRA contributions. The higher contribution limit will allow that couple to make larger IRA contributions during the years they can afford to do so.

Let me also note that in the course of our experience with millions of IRAs we have found that there is a very strong correlation between the size of an account and the attention and discipline that an individual affords to that account. Put simply, once an account achieves a certain "critical mass," it becomes the individual's nest egg and they become much more disciplined with respect to that account balance. They become less likely to make withdrawals and more likely to continue adding to the account. Conversely, relatively small accounts have a tendency to go dormant after only one contribution and are more likely to be withdrawn. Of course, every person's "critical mass" is different, but by raising the maximum initial IRA contribution, the chances that more people will start down the savings path (and stick to it) will be increased substantially.

ELIMINATE COMPLEXITY

Today, eligibility for traditional deductible IRAs, Roth IRAs and spousal IRAs can be determined only after the taxpayer works through a complex maze of eligibility requirements that include a variety of income limitations and phase-outs. Which of the various eligibility limits applies depends, in part, on the type of IRA the individual wishes to establish and whether the individual (or the individual's spouse) actively participates in certain types of employment-based retirement plans.

The current IRA eligibility limitations (which were initially included in the Tax Reform Act of 1986) are unnecessarily complex and counterproductive -- doing far more harm than good. Those limitations substantially impair the potential effectiveness of IRAs as a savings promoter and should be repealed as proposed in S. 646. Without the income limits, we would see increased savings among <u>all</u> income classes and would also eliminate the marriage penalties that are inherent in the structure.

Even with the improvements included in the 1997 Act, many middle income Americans are still not eligible for a fully deductible IRA. For couples with income above $51,000 and individuals with income above $31,000, the fully deductible IRA is generally not an option. Although the Roth IRA was wisely made available to a broader segment of the population, the application of income limits on Roth IRAs remains detrimental.

To begin with, the current income limits impose a severe marriage penalty on certain couples. Take, for example two individuals who will earn $30,000 each this year. If they are unmarried, both are allowed to make fully deductible $2,000 contributions to an IRA. If they marry, however, their IRA deductions will be reduced to $200 each. Under today's tax rules, that couple faces an increase of $1,250 in their Federal income taxes just for getting married, and $1,000 of that marriage penalty (about 80%) is attributable to the eligibility limits currently imposed on deductible IRAs. S. 646 would eliminate that marriage penalty.

Our experience has also shown that the people who are harmed most by the income limits are not the wealthy. To the truly wealthy, the relatively small IRA tax advantage has little affect on their

overall tax burden. The people who are harmed by the income limits are those who are stuck in the middle. These are people who do not necessarily have sophisticated tax planners and accountants giving them advice. They will only proceed in committing their money into an IRA if they are confident that they will not get tripped up by the rules. Some of these people will delay contributions to make sure they will qualify, and then later forget to make the contribution or spend the money before they get around to making a contribution. Others may qualify for a full or partial IRA this year, but still will not contribute because the contribution permitted this year is too small, or because they assume they won't qualify in the future and they don't want to start contributing if they are not sure they will be able to continue the process in future years. Still others are confused and believe they may have to withdraw the funds if their income goes up in the future.

The end result of today's complicated limits on IRA eligibility is that contributions are not made by many of those who are technically eligible (or partially eligible) under the rules in a given year. This same chilling effect has been in effect since Congress originally imposed income limits on deductible IRA eligibility in 1986. Before the 1986 Tax Reform Act, the IRA was available to all Americans with earned income. The year after the income limits on IRAs went into effect, contributions by those who remained eligible dropped by 40%.[1]

In restoring universal IRA eligibility and -- the rule that was in effect before 1986 -- S. 646 would help all Americans to save more. By eliminating the complexity in the current rules, Americans will be presented with a consistent and understandable pro-savings message -- a clear consensus path to follow toward retirement security. That message will be reinforced by the general media, financial press, financial planners, and word-of-mouth. As families gain confidence in the retirement savings vehicles available to them, more and more will commit to the consensus path.

CATCH-UP CONTRIBUTIONS

S. 646 would also allow those age 50 and older to make additional IRA contributions of $2,500 per year. This change could be a critical step in helping people who are closer to retirement to save more. We believe that this type of targeted change could be particularly effective because as people approach retirement age they become more focused on retirement needs. In many cases, individuals forego making an IRA contribution in a particular year because of insufficient income, illness, temporary unemployment, a decision to stay home with children, or pay for their children's education. Annual contribution limitations prevent these individuals from making-up for lost retirement savings once the cash-flow crisis is over or their income rises.

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[1] Testimony of Lawrence H. Summers, currently Deputy Secretary of the Department of the Treasury, before the U.S. Senate Committee on Finance, September 29, 1989.

Women, in particular, are more likely to have left the paid workforce for a period of time to care of children or elderly parents. During those years they were probably not eligible (or did not have the resources) to make retirement savings contributions. Allowing an IRA catch-up would help ensure that a woman's decision to fulfill family responsibilities does not have to lead to retirement insecurity.

It is also worth noting that many of those in today's population who are approaching or have reached age 50 did not have IRAs or 401(k) plans available through most of their working careers. They did not have the same opportunities to save that today's generations have. Instead, due to changes in the structure of the American workplace, they were caught in the transition from a relatively robust system of defined benefit pensions to the self-reliance focus of today's defined contribution landscape. Giving the baby boom generation the chance to catch-up for years they may not have saved adequately is not only fair, it is critical to helping them build a bridge to a financially secure retirement.

* * * * * * * * *

In the end, each American must accept significant responsibility for his or her own retirement security. But the government must help by reducing the tax burden on those who save and by making the choices simple and understandable. With that end in mind, our national retirement savings strategy must include an effective set of incentives that will expand personal savings. And the proven IRA vehicle should be the backbone of that effort.

The IRA changes enacted in the 1997 Act were a significant first step toward an improved set of rules for promoting personal savings. But more remains to be done. Today, with an improved federal budgetary picture, it is time to act on additional proposals, like those included in S. 646, that will directly address America's impending retirement savings crisis. Enhanced retirement savings incentives are the most effective investments we can make as a nation. Those investments will pay back many times over in increased retirement security for Americans and in a stronger economy. For these reasons we urge the members of this Committee to include proposals that will strengthen the IRA as part of any legislation that is reported this year.

SAVINGS COALITION OF AMERICA MEMBER ORGANIZATIONS

Aetna Retirement Services
Alliance of Practicing CPAs
American Association of Engineering Societies
American Century Investments
American Council on Education
American League of Financial Institutions
Americans for Tax Reform
Bank of America
Charles Schwab Corporation
Citigroup
Coalition for Equitable Regulation and Taxation
Consumer Bankers Association
Credit Union National Association
Edward D. Jones & Company
Financial Network Investment Corporation
G. E. Capital
HD Vest Financial Services
Household International
Independent Insurance Agents of America
Institute of Electrical & Electronics Engineers - U. S. Activities
Investment Company Institute
Merrill Lynch & Company, Inc.
Mortgage Bankers Association of America
National Association for the Self-Employed
National Association of Federal Credit Unions
National Association of Independent Colleges and Universities
National Association of Uniformed Services
National Taxpayers Union
Prudential Securities, Inc.
Retirement Industry Trust Association
Savers & Investors League
Securities Industry Association
The Bankers Roundtable
United Seniors Association
Wheat First Butcher Singer

A.G. Edwards, Inc.
America's Community Bankers
American Bankers Association
American Council for Capital Formation
American Express Financial Advisors
American Nurses Association
Association of Jesuit Colleges and Universities
Bankers Pension Services
Chase Manhattan Bank
Citizens for a Sound Economy
College Savings Bank
Countrywide Credit Industry
Delaware Charter Guarantee & Trust Company
Fidelity Investments
First Trust Corporation
Gold & Silver Institutes
Home Savings of America
Independent Community Bankers of America
Institute for Research on the Economics of Taxation
International Association for Financial Planning
Lincoln Trust Company
Morgan Stanley Dean Witter
NASDAQ Stock Market
National Association of Enrolled Agents
National Association of Home Builders
National Association of Realtors
National Rural Electric Cooperative Association
PaineWebber, Inc.
Resources Trust Company
Retirement Accounts, Inc.
Scudder Kemper Investments
Sterling Trust Company
USAA
United States Chamber of Commerce

United States Committee on Finance
Hearing on Cash Balance Pension Plans and Other Pension Issues
June 30, 1999 (or later if it should be rescheduled)

Chairman Roth, Ranking Member Senator Moynihan, and members of the Committee. Thank you for including my written testimony in the hearing record for today's hearing.

My name is Vicki Thompson. I am a 20-year employee of IBM from Colorado. On July 1, 1999 my company will convert from its traditional defined benefit pension plan to a "cash balance" pension plan. As a result of this conversion, I will lose approximately 40 % to 50% of the value of my pension, which will translate into a dollar loss of approximately $300,000.00 by age 55. I am able to provide only approximate loss calculations because my employer has refused to provide me with more specific information regarding the difference between the old plan and the cash balance plan.

For me, this is a very serious loss. I do not believe that I will be able to make up for the lose of $300,000.00 dollars. I am 45 years old and I have tried to save as much as possible for my retirement but there is no way I can make up the difference. I will probably have to continue to work until the age of 65 or 70 because of the money that I have lost with the "cash balance" pension plan. We were always told "Don't rely on Social Security" so we save in other ways to make up for that lose. But we were not told until now that we would lose 50% of our pension.

While I am losing this value, IBM has announced that it will save 200 million per year from this pension change.

Current law allows companies to make these changes to employee pension plans without even disclosing the actual benefit cuts. Congress must change this. How can an employee make a career decision when they do not have any financial facts to base their decision on. I need to decide if I want to quit IBM and go work for another company. The whole pension plan change was handled very unfairly. I am outraged at how IBM has handled this pension change. They totally left the employees in the dark while they run away with their pension money. Employees deserve to know how they are being affected. I urge the Committee to act quickly and favorably on Senator Moynihan's bill, the Pension Right to Know Act (S.659).

Thank you very much,

Vicki Thompson
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Thornton, CO. 80221

Senator Bill Roth (Attn: Bill Sweetnam)
Senate Finance Commitee
219 Dirksen
Senate Office Building
Washington, DC 20510

United States Committee on Finance
Hearing on Cash Balance Pension Plans and Other Pension Issues
June 30, 1999

Chairman Roth, Ranking Member Senator Moynihan, and members of the Committee. Thank you for including my written testimony in the hearing record for today's hearing.

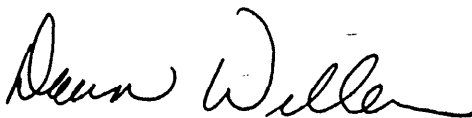
My name is Dawn Weller. I am a 17-year employee of IBM from Lyons, Colorodo. On July 1, 1999, my company will convert from its traditional defined benefit pension plan to a "cash balance" pension plan. As a result of this conversion, I will lose approximately 30% to 50% of the value of my pension, which will translate into approximately $150,000 - $250,000 of lifetime loss. I am able to provide only approximate loss calculations because IBM has refused to provide me with more specific information regarding the difference between the old plan and the cash balance plan.

For me, this is a very serious and demoralizing loss. I have two kids who will be in college in the next 3-8 years and a six year old child. I was planning to retire at age 58 (with 30 years) and take care of aging parents, but still have the income needed to sustain our family, put my child through college, etc. If I would have known about this plan change, I would have planned both my career and retirement savings differently. I will have to work an additional 10-12 years to recoup the losses. Had I known that the pension plan would be taken back (in mid stream, mid career), I would have worked for the highest bidder for the past 17 years. I have been a loyal, productive, and dedicated employee. Not giving mid career employees a choice to maintain the old plan is just plain wrong and immoral.

While I am losing this value, IBM has announced that it will save over $200 M from this pension change. Moreover, Lou Gerstner, the CEP received a salary and bonus of more than $22M last year. IBM stock is at an all time high.

Current law allows companies to make these changes to employee pension plans without even disclosing the actual benefit cuts. Congress must change this. If only you could feel the sick feeling I have in the pit of my stomach when I think of all the years of IBM touting "Respect for the Individual" and all the hard work, overtime, and heart I have put into my career. It is just not right that this can be taken from me without any recourse. I would never have stayed with IBM this long if I had known that the retirement plan would be so drastically reduced (and in such an underhanded and high pressure way). This is not fair. Employees deserve to know how they are being affected. I urge the Committee to act quickly and favorably on Senator Moynihan's bill, the Pension Right to Know Act (S. 659).

Thank you very much,



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