OVERSIGHT OF PENSION ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

MARCH 10, 1998

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OVERSIGHT OF PENSION ISSUES

TUESDAY, MARCH 10, 1998

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

The Subcommittee met, pursuant to notice, at 3:03 p.m., in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson (Chairwoman of the Subcommittee) presiding.

[The advisories announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE CONTACT: (202) 225–7601
March 3, 1998
No. OV–13

Johnson Announces Hearing on Oversight of Pension Issues

Congresswoman Nancy L. Johnson (R–CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on oversight of various pension issues. The hearing will take place on Tuesday, March 10, 1998, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m. In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include officials from the Pension Benefit Guaranty Corporation (PBGC), experts in the area of pension plan coverage, employers and other business representatives, and association representatives. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

PBGC insures the retirement incomes of more than 42 million American workers—one of every three workers—in about 50,000 defined benefit pension plans. A defined benefit plan provides a specified benefit at retirement, often based on a combination of salary and years of service. PBGC is financed through premiums collected from plan sponsors, returns on investments, and recoveries from employers responsible for underfunded terminated plans. PBGC currently pays monthly retirement benefits to about 200,000 retirees in over 2,348 terminated plans. The Ways and Means Committee considers legislation concerning PBGC premiums and also exercises jurisdiction over the tax treatment of pension plans.

Half of all American workers, over 50 million people, are without pension coverage. According to the U.S. General Accounting Office, 87 percent of workers employed by small businesses with fewer than 20 employees have no retirement coverage, and 62 percent of workers in small businesses with between 20 and 200 employees have no retirement plan coverage, while 72 percent of workers in firms with over 500 employees have some form of retirement plan coverage.

Coverage is most limited in the sector of the economy that provides most of the new jobs in today's workforce: small business. According to the Small Business Administration, 75 percent of the 2.5 million new jobs created in 1995 were created by small businesses. While many small businesses sponsor defined contribution plans, according to the U.S. Department of Labor, between 1987 and 1993, the number of small businesses with defined benefit plans dropped from 108,221 to 41,780—a 60 percent decline in seven years.

In announcing the hearing, Chairman Johnson stated: "It is alarming that half of all American workers are without pension coverage today, and that only 20 percent of workers in small businesses have pension coverage. We know how difficult it is for seniors to live on Social Security benefits alone. As the baby boomers approach their retirement years, the need to broaden pension coverage is greater than ever. We need to determine whether the complexity of pension law is coming between workers and the coverage they need."

FOCUS OF THE HEARING:

The hearing will focus on the current availability of pension plans to American workers, incentives for, and obstacles to, expanded pension coverage, the financial status and administration of Federally-insured pension plans monitored by PBGC, and related issues involving retiree health benefits.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) single-space legal-size copies of their statement, along with an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format only, with their name, address, and hearing date noted on a label, by the close of business, Tuesday, March 24, 1998, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

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

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

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

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

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record. The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

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

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE CONTACT: (202) 225–7601
March 9, 1998
No. OV–13-Revised

Time Change for Subcommittee Hearing on Tuesday, March 10, 1998, on Oversight of Pension Issues

Congresswoman Nancy L. Johnson (R–CT), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, today announced that the Subcommittee hearing on oversight of pension issues, scheduled for Tuesday, March 10, 1998, at 2:00 p.m., in the main Committee hearing room, 1100 Longworth House Office Building, will begin instead at 3:00 p.m.

All other details for the hearing remain the same. (See Subcommittee press release No. OV–13, dated March 3, 1998.)

Mr. PORTMAN [presiding]. The Subommittee will be in order.

Mrs. Johnson is taking care of some business, and she'll be joining us shortly.

Today, we are here to examine the issues surrounding our current pension system and the obstacles to coverage for a great number of workers. Because health care demands a significant portion of the incomes of many seniors, retired health care is also an important retirement income security issue, we also will be delving into that somewhat today.

All of us want to ensure that individuals are adequately prepared for retirement. Yet the complexity of Federal laws and regulations sometimes make that more, not less, difficult. This is especially troublesome, as many of you know in the small business sector, where currently 87 percent of workers employed by companies with 20 or fewer employees have no pension coverage whatsoever.

The SIMPLE, Savings Incentive Match Plan for Employees, defined contribution plan for small businesses that Senator Dole and I authored a couple of years ago, has been quite successful. But we need to do a lot more, and I am very pleased that Chairwoman Johnson and this Subcommittee are taking a careful look at this. Chairwoman Johnson has placed particular emphasis on that issue, and I congratulate her on the leadership she has shown in introducing a defined benefit plan for small business, SIMPLE being the defined contribution plan; Mrs. Johnson's being a defined benefit plan called the SAFE, Secure Assets for Employees Plan Act of 1997, plan.

They say imitation is the sincerest form of flattery, so Mrs. Johnson should feel especially proud and flattered that the administration has also sent forward its small business defined benefit plan, the SMART, Secure Money Annuity or Retirement Trusts, plan. So we have SIMPLE, SAFE, and SMART. We will hear more about those later today.

We're especially focused on small business today, as I said, but we also must continue our efforts to simplify the pension area for all businesses. My colleague Ben Cardin, with whom I worked to get pension simplifications in both the 1996 and 1997 tax packages, and I are working on additional provisions. The current patchwork of laws and regulations, we think works against a coherent national retirement income policy, and we are putting together a second simplification package which we hope to introduce within the next month.

I want to urge this Subcommittee and the Full Committee to continue to look at retirement issues in a broad-based way so that employers are not burdened by the complex regulations that so often negate the positive intentions of the laws we pass in this area.

I very much look forward to today's witnesses. And, again, Mrs. Johnson will be joining us at about 4 p.m. I would now like to yield to Mr. Coyne for a statement.

Mr. COYNE. Thank you, Mr. Chairman.

As you know today's hearing will focus on one of the most important issues facing American workers and their families: Pension coverage. Retirement income is an issue of concern to all Americans, whether they are currently retired, planning for retirement, or worrying about the economic stability of their retired parents and grandparents.

The PBGC, Pension Benefit Guaranty Corporation, ensures the retirement incomes of more than 42 million workers. The PBGC now shows a surplus for the first time in 22 years of its history. At the same time, about two thirds of our single employer plans are fully funded, with assets of over $1 trillion. This is great news for all workers who are currently covered by private pensions. It means that they can count on their pensions being there when they are ready to retire. But at the same time, more than half of all American workers, about 50 million people, do not have any retirement coverage at all. When they retire, they will have to depend on Social Security payments, their personal savings, and the generosity of friends and families.

It is within the Subcommittee's oversight responsibilities to ask why this is and what can we do to expand coverage. In Pittsburgh, the city that I represent, 43 percent of my retired constituents do not have private pensions. A Social Security check, which averages less than $750 a month in Pennsylvania, is all most of them have to pay their bills.

One of their greatest fears is that they will need expensive health care or prescription drugs, because many employers are dropping retiree health coverage, leaving their former workers completely dependent on Medicare and their personal savings.

The stories in my district are similar to those of Americans across the country who do not have pensions. Most of them work for small businesses. Many of them work for wages that are so low that they cannot contribute to a retirement plan, which often results in them not having retirement plans at all. Some of them never worked for any one employer long enough to be vested in the retirement plan. Many of them are widows living alone. Three-fourths of the elderly poor are women, and one of the primary reasons is lack of private pension coverage. Women tend to move in and out of the labor market, work at home, and earn less for what they do. All of these factors make them likely to have very small pensions or none at all.

I wanted to point out that the Teresa and John Heinz Foundation in Pennsylvania has just published a retirement guide for women. This commonsense guide to retirement issues is excellent. I will provide a copy for inclusion in the record with the approval of the Chairman.

Mr. PORTMAN. Without objection.

Mr. COYNE. The problem of men and women without pensions is not new, and Members of Congress have been concerned about it for many years. My colleague, Chairwoman Johnson, has been particularly active in trying to solve this problem over the years. Despite our best efforts, many small business employees, low-income workers, and women still do not have pensions. We need to focus on helping these groups, which are the majority of the pensionless and of the elderly poor.

Today's hearing will give us an opportunity to discuss and analyze the administration's fiscal year 1999 proposal for expanding pension coverage by small businesses. We also have an opportunity to consider Congressman Kleczka's bill, H.R. 211. It addresses another critical issue in retirement security: The declining levels of retirement health benefit coverage. We will also hear from a number of other individuals who have spent many years studying this issue. I think they will give us a deeper understanding of the problems retirees and their employers face, but I hope that they will also suggest solutions.

We need to find a way to help those who need it the most: Small business employees, women, and the working poor.

Thank you, Mr. Chairman.

Mr. PORTMAN. Thank you. And without objection, the guide from the Heinz Foundation will be entered into the record.

[The information follows:]

What Every WOMAN Needs to Know About MONEY AND RETIREMENT

A Simple Guide

A Project of the Teresa and H. John Heinz III Foundation and Good Housekeeping
Underwritten by: Morgan Stanley, Dean Witter, Discover & Co., and the Teresa and H. John Heinz III Foundation

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Prepared by

Cindy Hounsell, executive director,
the Women's Institute for a Secure Retirement (WISER), and
Jeffrey R. Lewis, executive director,
the Teresa and H. John Heinz III Foundation
Illustrations by John Pirman

April 1998

From the Chairman of the Teresa and H. John Heinz III Foundation

Dear Reader:

After a lifetime of hard work, inside or outside the home–or both–women should be able to look forward to a financially secure retirement. Unfortunately, in far too many cases, that is not how it works. Women are far more likely than men to live out the end of their lives in poverty.

Six years ago, the Teresa and H. John Heinz III Foundation started examining why poverty in old age has a distinctly feminine face. What we discovered is a retirement system that is not well-suited to the work patterns of women, who continue to bear the overwhelming share of responsibility for caregiving in our society.

The Foundation has worked to bring these inequities to the attention of policy makers and the public. It is equally important to educate women about the importance of saving and planning for retirement and about how to take control of their financial futures.

This booklet provides essential information that every woman, young or old, should know as she makes decisions that will affect her financial security. If you have questions or would like additional information, please contact the Women's Institute for a Secure Retirement (WISER) at the address listed on the back cover.

Sincerely,

Teresa Heinz

Teresa Heinz

April 1998

From the Editor in Chief of Good Housekeeping

Dear Reader:

We all know we're supposed to pay attention to money matters, but many of us don't. Why? Maybe because the subject seems boring or intimidating to us. Or maybe we just figure that, like Scarlett O'Hara, we'll think about it tomorrow.

In assembling this booklet, the editors at *Good Housekeeping* resolved to help change women's attitudes about money—and to provide a handy, easy-to-follow resource guide that answers questions about everything from pension benefits to individual retirement accounts. Another problem some of us have is retaining financial facts—we may understand what a no-load fund is when it's explained to us, but the information doesn't stick in our minds. Here, then, is a booklet to keep on hand and use, on an ongoing basis, as a reference manual.

One final thought: It's never too early—or too late—to take control of your financial future. However, just like losing weight or giving up smoking, it's something you really have to do for yourself. The rewards, of course, are considerable. Thanks to medical breakthroughs, lots of us will live to a ripe old age—and by making the right money moves now, we can look forward to a long and happy retirement, free of financial anxiety.

Sincerely,

Ellen Levine

Ellen Levine

Overview
Just the Facts

Although women need more money for retirement than men do, they usually end up with far less.

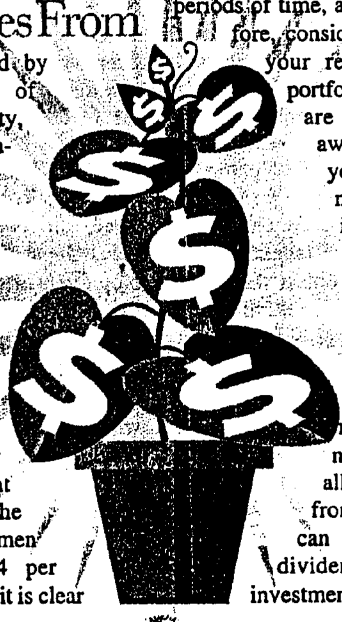
Fact One: Longevity Women, on average, outlive men by five years.
Fact Two: Lower Earnings Women typically earn less money than men, so the amount of their retirement benefits is lower–in both pension and Social Security payments.
Fact Three: Caregiving Women often leave the workforce to care for children or aging parents for a certain part of their work lives–another reason they accumulate fewer retirement benefits.
Fact Four: Moving On Women often leave their jobs too soon to qualify for a pension.

PART I

Where Retirement Money Comes From

Retirement is supported by three main sources of income: Social Security, employer-sponsored pension plans, and individual savings.

Social Security
Social Security provides a foundation of support or safety net. Unfortunately, many retirees, particularly women, rely on Social Security as their primary source of retirement income. Given that the average benefit for women workers is only $644 per month, or $7,728 a year, it is clear that Social Security alone is not effective in protecting women from poverty.



Pensions
Think of a pension as a series of delayed paychecks that you receive upon retirement. Employer-sponsored pensions are a crucial source of retirement income. Yet women are less likely than men to earn pensions, because they are more likely to work in lower-paying or part-time jobs where pensions are not available. Those who do earn pensions receive less than half the benefits men receive.

Savings and Assets
Your assets are an increasingly important part of your retirement plan, so it is essential to start saving early and to invest wisely. This means choosing investments that are appropriate for your age, tolerance for risk, and current need for cash. Stocks, for example, often produce greater returns over long periods of time, and you should, therefore, consider including them in your retirement investment portfolio, especially if you are a number of years away from retirement. If you are closer to retirement, you may want to invest more conservatively. According to the Social Security Administration, nonmarried women retirees over age 65 receive a median payment of only $95 per month or $1,140 annually in interest income from their assets. But you can realize much greater dividends from your own investments.

A Guide to Social Security

A working woman earns Social Security because she pays into the system at her place of employment. She may also collect benefits as a spouse or as an ex-wife—provided she was married for ten years or more. A woman may collect Social Security either on the basis of her own work record or, if the benefit to which she would be entitled is greater, as a spouse. She cannot collect both full benefits!

Taxes

Your Social Security benefits may be taxable, depending on your total income. For instance, if you file a federal tax return and the combined income of you and your spouse is between $32,000 and $44,000, you may have to pay taxes on half of your Social Security benefits. If your combined income is above $44,000, up to 85 percent of your benefits are subject to income tax.

When can I receive Social Security and Medicare benefits?

Age 65 is the current age at which you will qualify to receive full Social Security benefits. Beginning in the year 2003, the age at which you will be able to receive full benefits will gradually rise to 67.

Age 65 is when you are eligible to enroll in Medicare, the federal health-insurance program. Contact the Social Security Administration at 800-772-1213 several months before your sixty-fifth birthday for more information.

You may also receive reduced Social Security benefits at:

Age 62 if you want to retire early.

Age 62 if you are divorced, you were married ten years or more (and aren't currently married), and your ex-spouse is eligible for retirement benefits.

Age 60 if your husband or ex has died.

Age 50 if you are a disabled widow.

Also: If you are a widow and must stay home to care for young children, you may be eligible for a survivor's benefit, regardless of your age. This is paid until your youngest child reaches age 16.

These benefits are not automatic. You must apply to the Social Security Administration to receive them.

For how long can I collect Social Security benefits?

These benefits will continue for as long as you live, and are currently adjusted every year for inflation.

Do I get benefits if I left the paid workforce to care for my family?

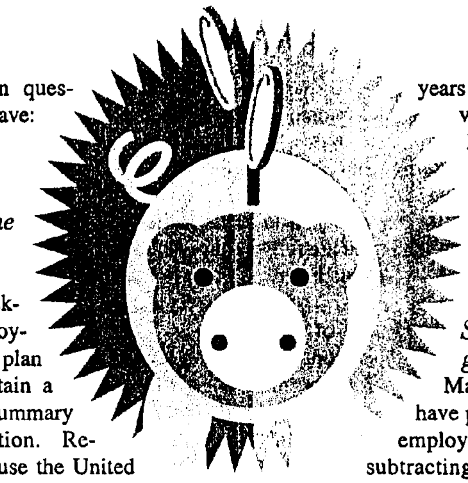
Social Security benefits are based on an individual's average earnings over 35 years, but a person who works for at least ten years will generally qualify for some benefits.

What is SSI?

SSI stands for Supplemental Security Income. It pays a monthly benefit to people over age 65 who have very little income, or younger persons who are disabled and poor.

A Guide to Pensions and 401(k)s

There are two categories of pension plans: In a defined benefit plan, your employer often provides all of the money and selects an administrator to make investment decisions; upon retirement, you get a specific monthly benefit. In a defined contribution plan—which includes 401(k)s—you may provide all or a portion of the funds and make investment decisions; sometimes your employer matches all or part of your contribution. Increasingly, employees are being asked to pay for all or part of their own retirement. Here are some common questions women have:



How do I become a member of the pension plan at my job?

■ Start by asking your employer if a pension plan exists and obtain a copy of the summary plan description. Remember, because the United States has a voluntary system, many employers do not offer pensions.

■ If your employer offers a plan, find out if you are eligible. The law allows your employer to decide which employees will be covered by the pension plan. Many women work part-time or for companies that classify them as independent contractors rather than employees, which means they are unlikely to be included in the company's pension plan.

How many years do I need to work to be eligible for a pension?

Usually, you need to work between three and seven years at the same company to be "vested," which means you should not have to forfeit your right to the money your employer contributed on your behalf.

A cautionary note: You can still lose a small percentage of your pension for each year you've retired before the normal retirement age, which usually is 65. In other words, the earlier you retire, the smaller your monthly benefit.

What happens to my pension if I leave my job?

If you decide to change jobs, carefully examine your plan's rules so that you do not lose any benefits. For example, if your plan requires you to work five years before becoming vested, and you leave after four and a half, you may lose all your accumulated benefits.

What is Social Security integration?

Many companies have plans that reduce employee pensions by subtracting part of the Social Security benefit. Called Social Security integration, it primarily affects low-wage workers.

What is a 401(k) or 403(b) plan? How is it different from a pension?

• A 401(k) plan is an employer-sponsored savings arrangement that permits you to set aside money for retirement. All of the money you save through a 401(k) plan is tax-deferred. You pay tax only when you start to withdraw the money, which is permitted at age 59½, when your tax rate is expected to be lower than it is now. The amount you contribute helps reduce your current taxable income. Early withdrawals are normally subject to a penalty in addition to income taxes. These 401(k) plans are not insured by the Pension Benefit Guaranty Corporation, an agency of the federal government that guarantees pensions when companies fail. And federal law does not require audits of plans with fewer than 100 participants–which means that 401(k) funds in small companies may be vulnerable to mismanagement and other abuses.

• Advantages: In addition to lowering your taxable income, a 401(k) plan is "portable" because you can take the amount you've contributed to your account, plus earnings, when you change jobs. (This often is not true of traditional pensions.) The money can be rolled over into an individual retirement account (IRA) or another qualified 401(k) plan. Some employers even contribute to or match your contribution. If you are fully vested, you may take your employer's contribution with you as well.

- Disadvantages: The amount of your retirement income will depend on your personal investing skills and on the amount of money you have been able to contribute. And some people just can't afford to participate.
- A 403(b) plan operates very much like a 401(k), and is used by tax-exempt organizations.

How can I get the most out of my company's retirement plan?

Read the pension-plan booklet carefully, and make a list of any terms or rules you do not understand. Once a year, you may request an individual benefit statement from your pension plan. Pay particular attention to the type of formula that will be used to compute your benefit. Make an appointment with the plan administrator–usually someone in your human resources department–to discuss any questions you have.

What do I need to know about survivor's benefits?

■ If you are married when your husband retires, you are normally entitled to a widow's benefit if he dies before you–*unless* you agree to sign away your rights to a survivor's benefit. The widow's benefit is called a "joint and survivor annuity," and it ordinarily guarantees you half the pension the two of you were receiving.

■ Before your husband retires, he will be asked whether he wants to receive his pension in that form or some other form, such as a "lifetime benefit" or a single payment (lump sum). If he opts for the "lifetime benefit" or the single payment–both of which *eliminate* the widow's benefit–he must have your consent. You will be asked to sign a "spousal-consent form." *Read this form carefully.* It can be quite confusing. You might even want to consult a lawyer.

■ Often the spousal-consent form will list a series of options for you and your husband to consider. The so-called lifetime benefit usually provides the highest monthly benefit, so people are often tempted to select it. But remember, it will be paid only while your husband is alive. And if the pension includes retiree health benefits, these may stop, too, if you are widowed.

■ The joint and survivor annuity offers a somewhat smaller monthly payment. But it guarantees a steady stream of income for two lifetimes (the husband's and the wife's). For women who expect to depend on their husband's pension as a source of income in retirement, this is generally the better option. Under a lifetime benefit, for example, while your husband is alive, the pension might be $1,600 a month, while under a joint and survivor annuity, the benefit might be $1,300 a month. By this formula, when he dies, your benefit would be $650 a month.

■ Do not assume that your husband understands his choices or the spousal-consent form. He also may not realize that, statistically, you are likely to outlive him.

■ The last chance you have to make sure you receive a survivor's pension is at the time your husband retires, so don't sign away your rights *unless* you understand what you are giving up.

Public Employees Take Note

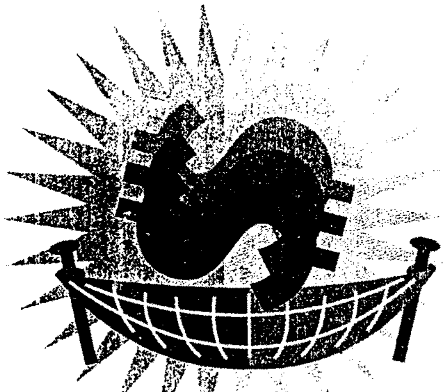
Reductions in Social Security benefits: If you are receiving a pension based on your work in a federal, state, or local government job and that work was not covered by Social Security, then the benefits you would receive from Social Security as a widow may be reduced. Contact the Social Security Administration for more information.

Joint and Survivor benefit: If your husband worked for a federal, state, or local government that does not require the payment of Social Security taxes, make sure he selects a joint and survivor annuity option for his pension, guaranteeing you a survivor's benefit. Unless you have your own Social Security and pension benefits, the spousal benefit is all you would be entitled to, with the possible exception of SSI (see page 6).

What should I do to protect my pension rights if I'm getting a divorce?

Under the divorce laws of every state, a pension earned during a marriage is considered to be the marital property of both husband and wife. But the laws do not automatically require that pension assets be divided at divorce. In order to receive a portion of your husband's pension(s), you must ask for your share at the time of divorce–*not* later when your husband retires. The court should then award you a share as part of the divorce or legal separation proceedings. If your husband has more than one benefit plan–for instance, a 401(k) plan and a traditional pension–your settlement must refer to each plan in order to get benefits from both.

- Obtain as much information as possible from your husband's company benefits office. Usually your lawyer will have to write a letter to obtain this information, but the law does consider you a beneficiary with the right to receive information. Notifying the pension-plan administrator in writing that you are in the process of a divorce may temporarily prevent the plan from paying out your share of the pension to your husband.
- A pension may be divided in many ways. However, if you want to receive a survivor's pension, you will need to ask for it specifically, since it must be mentioned separately in the same divorce decree or property settlement. If your husband previously chose a survivor's benefit for you, you are entitled to receive it regardless of the divorce (unless it's a government pension).
- To make sure the pension plan recognizes your right to a portion of your husband's pension after the divorce, you need to obtain a separate court order. This special order is called a "qualified domestic-relations order" or QDRO (pronounced *quadrow*). When the court issues a domestic relations order awarding you a share of your husband's pension, a copy must be sent to the pension plan immediately. Generally, the plan will want to make sure of two things: 1. that the court order contains all the necessary information so the plan can determine who, what, and when to pay; and 2. that the court order does not require the plan to pay you in a form or at a time that would not otherwise be permitted. For example, a court cannot order a plan to pay you your share in a lump-sum payment if the plan does not allow employees to draw their pensions this way.
- As soon as the divorce proceedings begin, have your lawyer contact the plan administrator for the written QDRO procedures. Each pension plan is different, and many companies have developed their own QDRO forms to make it easier for the court and the ex-spouse. The responsibility for the preparation of



the QDRO rests with your attorney.

- Settle all pension issues before your divorce is finalized by the court. If the pension is mentioned in your property settlement, but you do not get a QDRO at the time of your divorce, then you will have to go back to court later to obtain it. That means that you will have to pay additional legal fees–and run the risk of losing your share of the pension.
- Beware of trade-offs offered by your spouse. For example, your husband may want to give you the house or some other tangible asset in exchange for your giving up the rights to his pension. But the value of your share of the pension may be higher than the value of the assets you are offered.

What do I need to know about my rights as a second wife?

If your husband was previously married, a former wife may be eligible for a portion of his retirement benefits and savings. The rights of the former spouse are spelled out in the divorce settlement and QDRO. You'll need to check those documents to determine what you're entitled to. If your husband's former spouse dies before your husband retires, you may be eligible for some or all of his pension benefits. Regardless of the number of times your husband was married, you qualify for survivor's benefits under Social Security.

All About IRAs

If your employer or your husband's employer does not offer a pension plan or 401(k), it's especially important that you start making contributions to an individual retirement account (IRA). You can establish an IRA through most financial institutions–banks, brokerage houses, credit unions, etc. There are several types of IRAs, but most require that you wait until age 59½ to begin withdrawing money without penalty. Each type of IRA offers different tax benefits. Your total individual contribution to all your IRAs is limited to $2,000 per year. The deadline for the annual contribution is April 15 of the following year, though the earnings will accrue more quickly if you contribute earlier.

The traditional IRA offers two tax breaks. First, the federal government allows you to delay paying tax on the money you contribute. For example: If you earn $25,000 in a year and put $2,000 into an IRA, you'll pay taxes on just $23,000. Second, all of your investment earnings from an IRA are tax-deferred. This means that no taxes are paid until you start to withdraw the money at age 59½. If you withdraw any money before then, you may have to pay a 10 percent penalty in addition to the regular income tax. But beginning this year, you are allowed to make penalty-free withdrawals for college tuition and catastrophic illness, as well as up to $10,000 for a first-time home purchase.

The Roth IRA provides tax benefits at retirement rather than upfront. Contributions to a Roth IRA–up to $2,000 annually–cannot be deducted on your tax return. But when you begin withdrawing funds from your Roth IRA at age 59½, you will not have to pay any tax. The Roth IRA is available to anyone whether or not they participate in a company retirement plan. However, there are income limits: You cannot invest in this IRA if your adjusted gross income (AGI) exceeds $95,000 for singles and $150,000 for married couples. You can make a partial contribution if your AGI is below $110,000 for singles and $160,000 for couples.

The Spousal IRA: A full-time homemaker is now eligible for an IRA contribution of up to $2,000. Starting in tax year 1998, if your job doesn't have a retirement plan but your husband's does, you are still eligible for a fully deductible IRA. To qualify for either, a couple's AGI must be $150,000 or less.

The Nondeductible IRA: Some people won't qualify for any of the IRAs mentioned above or may only be allowed to make partial contributions. They are eligible for a nondeductible IRA, in which your money still grows, tax-deferred, until retirement. Annual contributions, though, are *not* tax-deductible.

SEP-IRA: These **Simplified Employee Pensions** are designed for self-employed individuals as well as for small-business owners and their employees. The owner or self-employed worker can contribute up to 15 percent of income, tax-free, for the first $160,000 of income.

SIMPLE IRA: Businesses with 100 employees or fewer can now offer the Savings Incentive Match Plan for Employees (SIMPLE), a salary-reduction plan similar to a 401(k).

Keogh Plans If you're self-employed, you can also set up a Keogh, a retirement plan that permits you to set aside substantially more money than you can in an IRA–in some cases, tax-free.

PART II

Take Control of Your Financial Future

A Guide to Savings and Investments

Financial planners say that Americans will need 60 to 80 percent of their pre-retirement income when they retire. Actually, women may need 100 percent of their pre-retirement income because: 1. Their incomes–and therefore their savings–are often lower; 2. They live longer; and 3. Inflation erodes buying power over those additional years.

Three Steps to Improve Your Financial Outlook

Step 1: Get started today–estimate the value of your assets and income. Assets are things you own, such as your home, car, bank accounts, IRAs, lump-sum payments from pensions, 401(k)s, stocks, bonds, and mutual funds.

Step 2: Determine if the payments from your pensions, Social Security, and savings and assets will meet your monthly expenses at retirement.

Request a statement from your employer that estimates the monthly pension benefit you are likely to receive. You may also request an estimated benefits statement from the Social Security Administration (call 800-772-1213). Finally, calculate how much income your savings will provide. Is the total enough to cover your projected monthly expenses? If not, consider saving more and investing those assets appropriately.

Step 3: Learn about investment choices as they pertain to your 401(k) plan or personal savings.

Your employer may offer you a "menu" of about four or five investment choices and allow you to divide your contributions as you wish. Make sure you understand each investment choice; select investments that best suit your age and your tolerance for risk, and consider including stock mutual funds in your plan. In the past, stocks have produced higher returns than bonds and other more conservative investments over a long period of time–although they have also shown greater volatility.

Definitions and Information

What is stock? Stock represents part-ownership in a company and is traded in units called shares.

What are bonds? Bonds are IOUs issued by companies, governments, or other institutions. The issuer agrees to pay back the face value of the bond–known as the principal–over a fixed period of time. In return for this "loan," the issuer also agrees to pay a fixed rate of interest to the bondholder for the life of the bond. Bonds are often less risky than stocks, but may also be less lucrative.

What are mutual funds? Mutual funds are investments that pool together the money of thousands of investors and invest this money in a variety of stocks, bonds, and/or other securities. Instead of purchasing, say, a particular stock, you purchase shares in a whole group of stocks. Mutual funds offer small investors the advantages of diversification.

What are load funds? Some mutual funds charge a commission called a "load"–a onetime fee paid when you buy or sell shares in the fund. Those funds that do not charge such a fee are called "no load."

Financial Advisers: Some Things You Should Know

Do I need a financial adviser to help me with my retirement investments? Many people can educate themselves by reading financial material in newspapers, magazines, and books, and by requesting information from local investment firms. However, if you are uncomfortable in this area, you may want to seek the help of a professional. There are two types of financial advisers: Fee-only financial advisers charge a flat fee or an hourly fee for the financial advice they give. They do not receive commissions from mutual funds or other financial products that they recommend. Commission-based financial advisers earn commissions on the investments that they sell. Some commission-based planners also charge a fee. The financial-planning profession is not regulated, so it's hard to judge a planner's qualifications. Try to find a licensed broker or a certified financial planner.

If you're interested in working with a financial adviser:

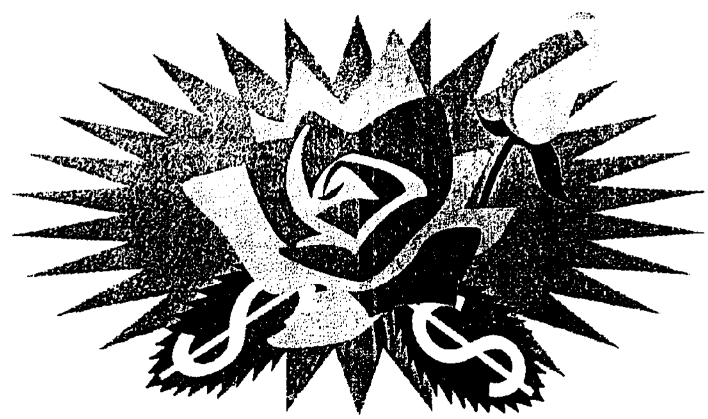
- Do not be afraid to interview two or three different ones.
- Beware of someone who promises too much.
- Ask the adviser how the services he or she provides are paid for.
- Find an adviser who will design a realistic investment program for you.

Insurance: Protecting Your Future Assets

If you're eligible for Social Security, you will qualify for Medicare, which provides basic coverage for your health needs starting at age 65. But many people purchase supplemental or "Medigap" insurance to help with costs not covered by Medicare. (Contact your state insurance department for further information.)

Here are three other types of insurance some experts think you should consider:

Disability insurance guarantees a monthly income if your ability to work is impaired by illness or injury. Cover-



age is designed to replace a reasonable percentage of your predisability income—sometimes as much as 60 to 80 percent. Even if your employer provides you with some coverage, you may wish to purchase an additional policy.

Long-term care insurance is most often associated with nursing-home coverage, but it can also cover other forms of custodial care if you are no longer able to manage on your own—for example, in-home health aides, or participation in adult day care.

Life insurance helps to replace the income of a spouse who dies prematurely. The simplest kind is called term.

For more information, call the National Insurance Consumer Helpline at 800- 942-4242.

PART III

In Sum

What Married Women Need to Know

- If your husband dies before you do, you can no longer receive the combined Social Security benefit. In other words, you will keep whichever benefit is larger, yours or your husband's.
- If your husband dies before you do, his pension is likely to be reduced or may stop. Even if you and your husband choose a widow's benefit, most plans pay only half the pension to the widow.
- If your husband dies before you do, your monthly expenses are likely to remain at 80 percent of what they were before. You will still need to pay for housing, utilities, transportation, medical care, and insurance.
- You are guaranteed some of your husband's pension because under the federal pension law, traditional company and union pension plans must provide a survivor's benefit to the wife if the employee dies first. The survivor pension can be forfeited only if the wife gives her permission in writing.
- Different rules apply to certain other retirement plans, such as 401(k)s and public-employee pension plans. You must find out what they are in order to receive your full benefit.

Additional Reading

1. *Get a Financial Life* (Beth Kobliner, Fireside Books, $12).
2. *Making the Most of Your Money* (Jane Bryant Quinn, Simon & Schuster, $30).
3. *Personal Finance For Dummies* (Eric Tyson, IDG Books, $19.99).
4. *The Only Investment Guide You'll Ever Need* (Andrew Tobias, Harvest/Harcourt Brace, $12).
5. *The Wall Street Journal Guide To Understanding Personal Finance* (Kenneth Morris and Alan Siegel, Fireside, $13.95).

Making Sense of It All
A Glossary

Annuity Regular payments of income, usually monthly, over a specified period of time, often for life.

Defined benefit plan A traditional pension plan, insured by the government, that pays a certain benefit usually based on your age at retirement, rate of pay, and the number of years you worked.

Defined contribution plan A retirement plan in which contributions are made by the employer, the employee, or both. The final payout will depend on how much is invested and the success of the investments. This type of retirement income is not insured by the government.

Early retirement age An age earlier than normal retirement (usually 65) at which an employee may begin to receive reduced benefits under a pension plan.

401(k) plan A voluntary savings plan in which employees contribute a portion of their pretax salary and employers may match some or all of their employees' contributions.

403(b) plan The nonprofit sector's version of the popular 401(k).

Individual Retirement Account (IRA) A retirement savings plan in which individuals can contribute up to $2,000 per year, and couples, up to $4,000. Under certain circumstances, this amount may be tax-deductible.

Joint and survivor benefit A pension that allows for a surviving spouse to receive a benefit if the worker or retiree dies first. The payment is usually half the worker's benefit.

Lump-sum payment Payment of an entire benefit all at one time.

Participation Whether a worker is included in a company's pension plan. Employers can exclude part-time workers, those who have worked less than one year, and, under certain circumstances, union members.

Pension integration An employer's subtraction of part of an individual's Social Security benefit from her pension benefit.

Portability The ability to take a vested retirement benefit from one company and transfer it to an individual IRA or retirement plan at another company.

Qualified Domestic Relations Order (QDRO) A special court order or a court-approved property-settlement agreement that requires a pension plan to pay a share of a pension to an "alternate payee"–that is, someone other than the employee (usually an ex-spouse).

Roth IRA A new type of IRA in which tax benefits come later rather than sooner. Contributions–up to $2,000 annually–cannot be deducted on your tax return; but when you begin withdrawing your funds at retirement, you will not owe any tax.

SEP-IRA Simplified Employee Pensions allow self-employed workers to save for retirement or small-business employers to provide pension benefits to their employees.

SIMPLE IRA A salary-reduction plan similar to a 401(k) for businesses with 100 people or fewer.

Social Security offset Another type of pension integration that affects those who work for federal, state, or local government and do not pay Social Security taxes. In this case, a widow's benefit from Social Security will be "offset" or subtracted from a pension that was not covered by Social Security.

Tax-deferred Money that is allowed to grow, tax-free, until you reach retirement age and start to withdraw it. (Withdrawals must begin no later than age 70½.)

Vesting The date when you acquire a nonforfeitable right to receive earned benefits from a savings or pension plan.

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Mr. PORTMAN. Our first witness is David M. Strauss, Executive Director of the Pension Benefit Guaranty Corporation I think you're going to give us a little background on PBGC, and then I hope some commentary on the SAFE plan, the SMART plan, and other defined benefit plan proposals that are out there.

Mr. Strauss.

STATEMENT OF DAVID M. STRAUSS, EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION

Mr. STRAUSS. Thank you, Mr. Chairman, Members of the Subcommittee.

I appreciate the opportunity to appear before you today to speak about the importance of defined benefit pension plans for America's workers. I want to thank the Subcommittee Chairwoman, Mrs. Johnson, for holding this hearing for the interest that she and the other Members of the Subcommittee have in the retirement security of America's workers, including workers in the Nation's most dynamic economic sector, small business.

As the Executive Director of the PBGC, I have set three priorities for the Corporation. Today, I want to concentrate on one of those priorities: Promoting defined benefit pension coverage. But first, let me briefly address the other two—safeguarding PBGC's solvency and making PBGC a premier customer service agency.

Regarding my first priority, PBGC's solvency, the corporation had its first surplus in 1996, and we fully expect to report good news again this year, when we release our annual report later this month. The single employer program, which as late as 1993 was running a deficit of nearly $3 billion, has now achieved a surplus that can serve as a cushion for future economic downturns. Mr. Chairman, your Subcommittee's efforts in enacting the Retirement Protection Act of 1994 have been an important factor in the single employer's program current sound financial condition. The multiemployer program also continues to be in good shape, with a surplus since 1982.

My second priority is to make the PBGC a premier customer service organization, not only for the workers and the retirees we protect, but also for the employers that pay our premiums and for the pension professionals who advise them. In my written testimony, I have provided you with a number of examples of steps we have taken to improve our customer service.

Now, let me turn to my third priority, which is the theme for this afternoon's hearing, "Promoting defined benefit pension coverage for American workers." Mr. Chairman, I have a very personal knowledge of just how valuable a defined benefit pension can be, especially for an older worker.

My father, who turned 88 last month, is that older worker. He's lived all of his life in North Dakota, and was a meat cutter in a grocery store when he retired at age 63 without a pension. He then took a part-time job for $1.75 a hour as a janitor at the local high school. For the first time in his life, he was covered by a defined benefit pension plan. He was making $6.25 an hour when he retired a second time, 15 years later.

The pension my father earned during those 15 years now provides him with $169 a month, a supplement of over 20 percent to his Social Security benefit. As the Subcommittee Chairwoman, Mrs. Johnson, has pointed out, we know how difficult it is for seniors to live on Social Security alone. So this pension of $169 a month makes a real difference. In addition, if my father dies before my mother, the pension plan will provide her with the survivor benefit for the remainder of her life. So I know from my father's experience how important a predictable, secure benefit for life can be, even one that may seem to many people a relatively small amount of money. I also know from my father's experience that a worker is never too old for a defined benefit plan and that a defined benefit plan can make a great deal of difference even for workers making very modest salaries.

Mr. Chairman, today too many American workers, including the huge cohort of baby boomers edging ever closer to retirement, have either no retirement savings or inadequate savings. And some have very few years left in which to save.

Defined benefit plans can offer a solution to this problem, but the number of defined benefit plans offered by small- and medium-sized employers has decreased substantially. As Mrs. Johnson, the Subcommittee Chairwoman, has pointed out when she joined with Congressmen Fawell and Pomeroy to introduce SAFE, the low level of pension coverage for workers in small business is particularly troubling, given that small business provides most of the new jobs in today's work force.

Millions of small business employees have no employment-based way to provide for their retirement. As opposed to over 60 percent of workers in large firms, only 20 percent of workers in firms with fewer than 100 employees have pension coverage. To help bridge this gap, we agree with Mrs. Johnson that small business needs a defined benefit retirement plan that is easy to administer.

Defined benefit plans have many advantages for workers and their spouses. They provide predictable, secure benefits for life.

Sometimes we forget that defined benefit plans can also help employers. For example, they promote company loyalty and help retain valuable workers. Today, many small business owners are baby boomers, not far from retirement age. Often, their businesses have only recently matured enough to be able to support a pension plan. If the owner and his or her workers have not been covered by an adequate retirement plan, it may now be too late to build meaningful retirement savings through a defined contribution plan. In the limited window that remains before retirement, a defined benefit plan allows a small business to provide meaningful retirement benefits for its middle-aged workers, and for older workers like my father, something difficult with only a SIMPLE or a 401(k) plan.

An important step in expanding the number of defined benefit plans is to enact legislation creating a simplified defined benefit plan for small business. Mrs. Johnson's proposal, the SAFE plan, and the President's proposal, the SMART plan, are similar. They both combine some of the best features of defined benefits and defined contribution plans and remove major obstacles that have prevented small business from offering defined benefit plans.

Under both plans, funding would be more predictable. Administrative costs and complexity would be reduced. Reporting would be simpler and benefits would be more understandable and portable. Both proposals would also give older workers, like my father, a chance to earn a meaningful benefit. At the same time, both would provide the opportunity for workers to benefit from investment returns, an especially attractive feature for younger workers.

Mr. Chairman, I would like to mention three aspects of the President's SMART proposal that I think are especially important.

First, SMART would provide for a true defined benefit plan with a predictable lifetime annuity for the participant and spouse.

Second, SMART would provide for a fair distribution of benefits between owners and their workers.

And third, SMART would provide workers in small businesses with a PBGC guarantee, the same protection we provide to other workers in defined benefit plans.

Although the funding requirements of the SAFE and SMART substantially reduce the risk to the worker, there are still circumstances that could result in a loss. We believe, therefore, that these plans should be insured by the PBGC. America's workers have come to expect a PBGC guarantee and to rely on the PBGC when their plans fail. The PBGC cannot guarantee these plans without an insurance premium; however, because these plans, by their design, may pose less risk, PBGC proposes that they pay a substantially reduced premium.

Mr. Chairman, the administration looks forward to working with Congress on a bipartisan basis, as we did in enacting the Retirement Protection Act in 1994 and SIMPLE in 1996. We need to give small business a workable defined benefit plan before this Congress adjourns.

I thank you again for allowing me the opportunity to testify before you this afternoon, and I will be happy to answer any questions you may have.

[The prepared statement follows:]

Statement of David M. Strauss, Executive Director, Pension Benefit Guaranty Corporation

Madam Chairman and Members of the Subcommittee:

Good afternoon. I am David Strauss, the PBGC's Executive Director. The Pension Benefit Guaranty Corporation (PBGC), established as a federal corporation by the Employee Retirement Income Security Act of 1974 (ERISA), protects the pensions of about 42 million workers and retirees in about 45,000 private defined benefit pension plans. PBGC's Board of Directors is chaired by the Secretary of Labor. The Secretaries of the Treasury and Commerce are also Board members. PBGC operates two insurance programs, the larger single-employer program and the multiemployer program. PBGC paid $824 million in benefits to over 200,000 people during FY 1997. Another 260,000 people will receive benefits when they retire in the future. PBGC receives no funds from general revenues. Operations are financed by three sources: (1) insurance premiums set by Congress and paid by plan sponsors; (2) investment income and assets from plans trusteed by PBGC; and (3) recoveries from companies that formerly sponsored plans.

I appreciate the opportunity to appear before you today to speak about the importance of defined benefit pension plans for America's workers.

I want to thank you, Madam Chairman, for holding this hearing and for the interest you and the other members of this Subcommittee have in the retirement security of America's workers, including workers in the Nation's most dynamic economic sector—small business.

As Executive Director of PBGC, I am acutely aware of how essential PBGC insurance is to safeguarding the pension benefits of American workers. The impact of what PBGC does takes on even a greater importance when you put faces to the numbers, as I have recently had an opportunity to do. I have met with hundreds of men and women in newly trusteed plans who worked for now-failed companies they thought would provide secure employment and benefits for the rest of their lives. You can imagine their relief when I was able to tell them that their benefits were safe.

Since coming to PBGC, I have also had the opportunity to fully appreciate the work of the Congress in enacting the Retirement Protection Act (RPA) of 1994. Your efforts in enacting these reforms have been an important factor in PBGC's shift from being a federal agency with serious problems to an agency in sound financial condition.

This turnaround in PBGC's fortunes has now provided me with the opportunity to address more general policy matters such as those before the subcommittee this afternoon—how to increase the availability of defined benefit pension plans in the crucial small business sector of our economy.

I set three priorities for myself as PBGC's Executive Director:

- Safeguarding PBGC's solvency;
- Making PBGC a premier customer service agency; and
- Promoting defined benefit plans.

Today, I want to concentrate on promoting defined benefit plans—but let me just briefly address my other two concerns.

SAFEGUARDING PBGC'S SOLVENCY

Last year PBGC had its first surplus in history, and we fully expect to report good news again this year, thanks to a healthy economy and good asset returns. The single-employer program, which as late as 1993 was running a deficit of nearly $3 billion, has now achieved a surplus that can serve as a cushion for future economic downturns.

The multiemployer program also continues to be in sound financial condition, with a surplus since 1982.

But PBGC has to be ever vigilant because there are many factors that affect our financial health that are beyond our control:

- We are always taking on new plans and assuming new unfunded benefit liabilities even when the economy is strong. In the last year alone we have trusteed pension plans with more than 50,000 participants.
- Changing economic conditions (such as a dip in the stock or bond markets) could reduce the value of the assets we manage.
- Decreases in long-term interest rates have the effect of increasing the present value of the benefits PBGC will pay for decades to participants of trusteed plans.
- And, of course, we have to be ready for economic downturns.

MAKING PBGC A PREMIER CUSTOMER SERVICE AGENCY

My second priority is making PBGC a premier service organization.

For workers and retirees:

- We operate a Customer Service Center with a toll-free telephone number, and respond to about 100,000 inquiries a year.
- PBGC Customer Service standards require that phone calls be answered within 24 hours, letters within a week, and status reports be given if the response will take longer.
- We use the Internet to locate missing participants so they can claim pensions that are owed them. Since the program began in 1996, we have located nearly 1200 people owed over $5 million dollars.
- We have improved communications with retirees and deferred vested participants.
- We hold meetings with participants of newly-trusteed plans to explain PBGC's guarantees and the processing of their plans.

For premium payers and their advisors:

- We revised our premium compliance program to reduce the administrative burden on those we audit, and we reduced late payment penalties for plans that correct underpayments before PBGC issues a written notice.
- We exempted small plans from reporting to PBGC on quarterly pension contributions.
- I established a "virtual town hall" through the Internet to communicate with premium payers and pension professionals.

Promoting defined benefit plans

My third priority is, working with the Departments of Treasury and Labor and others in the Administration, promoting defined benefit pension coverage for American workers.

Today too many American workers, including the huge cohort of baby boomers who are edging ever closer to retirement, have either no retirement savings or inadequate savings. Some have very few years left in which to save. The statistics are worrisome:

- About 50 million Americans—or nearly 50 percent of the private sector workforce—are not covered by an employer-provided retirement plan.
- Only 20 percent of small business workers are covered by a retirement plan.
- Many workers are not saving enough at a young enough age to fund their retirements adequately.
- Low wage workers often have the most difficult time setting aside savings. Many workers have difficulty grappling with investment decisions.

Defined benefit plans offer a solution for many of these problems. But defined benefit plans in small and medium-sized employers have decreased substantially.

Millions of small business employees have no employment-based way to provide for their retirement. Only 20 percent of workers in firms with fewer than 100 employees have pension coverage, as opposed to 62 percent of workers in firms with 100 or more employees.

As you, Madam Chairman, pointed out last May when you, along with Congressmen Fawell and Pomeroy, introduced SAFE (H.R. 1656, the Secure Assets for Employees Plan Act of 1997), the low level of pension coverage for workers in small business "is particularly troubling given that small business provides most of the new jobs in today's workforce...Small business needs a defined benefit retirement plan that is easy to administer..."

In 1996, the Administration and Congress worked on a bi-partisan basis to create the SIMPLE, a 401(k)-type of plan for small business. I hope we can work together again to give those same small businesses an additional option—a defined benefit plan tailored to their needs.

Defined Benefit Plan Advantages—Workers

Defined benefit plans have many advantages for workers and for employers. For workers, they provide a predictable, guaranteed, lifetime pension for the worker and often for the worker's spouse.

By predictable I mean:

- Benefits at retirement are predictable.
- Benefits are not subject to the ups and downs of the stock and bond markets.
- Benefits at retirement are not dependent on the amount a worker contributes to the plan.

By secure I mean:

- PBGC guarantees to pay most—often all—of the benefit if the plan cannot afford to pay for the benefits when the employer goes out of business.
- Older workers approaching retirement can earn a meaningful retirement benefit.

By lifetime I mean:

- The retiree is entitled to a monthly benefit for life no matter how long he or she lives.
- The retiree's surviving spouse is also entitled to a monthly benefit for life unless both have elected otherwise.

Defined Benefit Plan Advantages—Employers

Sometimes we forget the worth of defined benefit plans for employers:

- They promote company loyalty and help retain valuable workers;
- While the employer bears the investment risks for the plan, favorable investment returns and economic conditions, such as we are experiencing now, reduce employer costs and make it possible to increase worker benefits at nominal cost; and
- An employer can provide meaningful retirement benefits for workers, even older workers for whom the employer did not previously offer a retirement plan.

SMALL EMPLOYER DEFINED BENEFIT PLAN

Many small business owners are baby boomers not far from retirement age. Often their businesses have only recently matured enough to be able to support a pension plan. If the owner and his or her workers have not been covered by an adequate retirement plan, it may now be too late to build meaningful retirement savings through a defined contribution plan. A defined benefit plan can allow a small business to provide meaningful retirement benefits for its older workers, something difficult to do with only a SIMPLE or 401(k) plan.

An important first step in expanding the number of defined benefit plans is to enact legislation creating a simplified defined benefit plan for small businesses as you, Madam Chairman, the President, and other Members of Congress have proposed. These proposals combine some of the best features of both defined benefit and defined contribution plans. The proposals remove some of the major obstacles to small business defined benefit plans.

- Funding contributions would be more predictable—the employer would contribute an amount each year expected to fund the retirement benefit earned that year.
- Administrative costs would be lowered by reducing complexity and permitting simpler reporting.
- Benefits would be more understandable to the workers.

Your SAFE and the President's SMART are similar in many respects, and their goals are the same—to create a simple small employer defined benefit plan. Both SAFE and SMART:

- Give older workers the chance to earn a meaningful benefit even if they were not previously covered by a plan.
- Provide benefits to low-wage workers who would have difficulty making contributions.
- Cover all workers with two years of service and $5,000 or more in compensation.
- Provide that employee benefits are 100% vested at all times.
- Can provide all workers the opportunity to earn greater benefits if investment returns exceed expectations, an especially attractive feature for younger workers.
- Are portable.

As Executive Director of the PBGC, I would like to mention three aspects of the President's proposal that are especially important. First, SMART would provide for a fairer distribution of benefits between owners and moderate and lower-income workers. For example, SMART would limit the maximum compensation that may be taken into account in determining an individual's benefit for a year to $100,000 (indexed for inflation). Second, SMART would be a true defined benefit plan. It would provide a lifetime annuity for the participant and spouse. Third, SMART would provide workers with the same protections as other workers in defined benefit plans—a PBGC guarantee.

The funding requirements of the SAFE and SMART substantially reduce the risk of loss to the worker; however, there are still a number of circumstances that could result in a loss, such as an employer not making the required contribution. These plans should be insured by the PBGC. Since ERISA's enactment in 1974, America's workers have come to expect a PBGC guarantee and to rely on the PBGC when their plans fail.

PBGC cannot guarantee these plans without an insurance premium. However, because these plans, by their design, may pose less risk, PBGC proposes that they pay a substantially reduced premium.

We look forward to working with you on a bi-partisan basis as we did in enacting RPA in 1994 and the SIMPLE in 1996. Let's give small business a simpler defined benefit plan before this Congress adjourns.

I thank you again for allowing me the opportunity to testify before you this afternoon. I will be happy to answer any questions you may have.

Mr. PORTMAN. Mr. Coyne.

Mr. COYNE. Mr. Chairman, Richard Neal, a Member of the Subcommittee, asks that his statement be included in the record.

Mr. PORTMAN. Without objection.

Mr. COYNE. Thank you.

Mr. PORTMAN. Without objection, the opening statement is included in the record. Are there any other opening statements people would like to submit for the record?

[The opening statements follow:]

Opening Statement of Hon. Richard E. Neal, a Representative in Congress from the State of Massachusetts

First of all, I would like to thank Chairwoman Johnson and Representative Coyne for holding this very timely hearing. I think pensions are an extremely important issue and an issue Congress should be able to address this year.

I believe in the concept that retirement is based on a three-legged stool which consists of personal savings, Social Security and pensions. Forty percent of retirement income comes from Social Security. Nineteen percent comes from pensions and the rest comes from savings. Last session of Congress, we addressed personal savings by expanding individual retirement accounts (IRAs). Congressman Thomas and I worked toward this expansion which was included in the Taxpayer Relief Act of 1997.

Lately, Social Security has received much attention and I think this is an issue we need to address. I fully endorse the approach that President Clinton is taking. It is a very simple concept—to put Social Security first. Recently, Congressman Rangel introduced legislation which would reserve any budgetary surplus for Social Security. On March 4, the Congressional Budget Office announced that by the end of this year, we will have a budget surplus of $8 billion. This surplus should be used to reduce the debt.

In the near future, we need to address Social Security, but in the immediate future Congress should take action to improve our current pension system. We should make it easier for employers to offer pensions. Pensions should provide for more than 19 percent of savings. We need to make individuals more responsible for their retirement.

Our society has changed and no where are these changes more evident than in the workplace. It is now more common for individuals to change jobs than to stay with one firm for an entire career. This makes it extremely important for us to address pensions and especially the issue of portability. Changing jobs should not drastically affect one's pension.

Millions of Americans have no access to retirement plans. Only half of full-time, private sector workers participate in an employer-sponsored pension plan. This results in 51 million American workers with no pension plan. Pension coverage has only increased to 50 percent in 1993 from 48 percent in 1983.

Small businesses are less likely to have pensions than large businesses. While only thirty percent of firms that employ between 25 and 49 employees have pensions, seventy-three percent of firms that employ over 1000 employees have pensions. Only 8% of Americans making below $10,000 per year have pension coverage. Fewer women receive pensions than men. The percentage of the workforce covered by a pension has stagnated in the last 20 years. Many firms cite complexity and start-up costs as major reasons for not offering pensions.

Portability is important to improving our pension system. Five million people with pension coverage change jobs every year. Many workers lose out on their pension because they leave their jobs before their pension vests.

President Clinton's budget included comprehensive pension proposals. The proposals are aimed at making it easier for employers to offer pensions and for employees to retain pensions when switching jobs. The President's proposals are targeted to promoting pension plans among small businesses. These proposals build on past efforts of the President and Congress to simplify pensions. The President's measures would boost private pensions and individual retirement savings.

In the near future, I will be introducing the President's pension proposals in the form of legislation. This legislation will enhance workers' ability to contribute to an IRA by payroll deduction. The bill will provide a tax credit for small businesses with fewer than 100 employees for the start-up costs of a pension plan.

The legislation creates new simplified defined benefit pension plans for small businesses with fewer than 100 employees called the SMART plan. The SMART plan is a broad based approach that provides participants with a guaranteed minimum annual benefit upon retirement. An employee's benefit would be 100 percent vested at all times. The bill allows for faster vesting of employer matching contributions to defined contribution plans. Vesting for the employer match would occur at three years instead of five years. This should help with portability.

The bill will also include the expansion of right-to-know provisions for workers and spouses and simplification proposals. These proposals will help reduce the paper work associated with pensions.

The above described legislation is targeted to improve pensions in the areas where I believe the most improvement is needed—coverage for small businesses and portability. Now is the time for Congress to act. We cannot over look the statistics. We are beginning to face what has been commonly referred to as the "graying of America." Within thirty years, one out of every five Americans will be over age sixty-five. In thirteen years, the baby boomers will begin turning sixty-five. The baby boomer generation consists of 76 million members and will result in Social Security beneficiaries doubling by the year 2040.

We need to take action now to make retirement more secure. I see no reason that would prohibit Congress from passing legislation to improve our pension system. The way I look at the three legged stool of retirement is that the pension leg is wobbly. We can make that leg carry its weight by enacting pension proposals based on those included in President Clinton's budget. All three legs of the retirement stool need to be strong.

I look forward to working with this Subcommittee and the full Committee on making it easier for both employers and employees to have pensions.

Opening remarks by
The Honorable Nancy L. Johnson
Chairman, Ways and Means Subcommittee on Oversight
Hearing on Oversight of Pension Issues
March 10, 1998

Good afternoon. Today, we are here to examine the issues surrounding our current pension system and the obstacles to expanding coverage to a greater number of workers.

The baby boom generation will be retiring in record numbers in the not too distant future. We have all heard from the experts over the past few years that we need to strengthen retirement savings. Yet half of all American workers — over 50 million people — are without pension coverage.

According to the Labor Department, between 1987 and 1993, the number of small businesses with defined benefit pension plans dropped from 139,644 to 64,937. That is over a 50 percent decline in just seven years. Small business has been the engine that has driven new job growth over the past decade. Yet the General Accounting Office tells us that only 20 percent of employees in firms with fewer than 100 employees have pension coverage. Most pension experts agree that the complexity of our pension laws is a major cause of this pension gap.

In my state of Connecticut, we have about 85,000 businesses with 100 or fewer employees. These firms employ about 300,000 workers. If the national average holds true, about 240,000 of those 300,000 Connecticut workers don't have pension coverage. This is certainly sobering, particularly when one considers the looming retirement of the baby boom generation and the post-retirement lifespan that Americans enjoy today.

In today's hearing, we are going to hear about barriers to pension plan formation. I am pleased that one of our witnesses will be directing her comments on the particular impact of pension law on women, who, it is essential to note, have a significantly longer lifespan than men. This fact, in combination with lower pension coverage rates among women and lower average earnings, places women at greater risk of poverty in their golden years.

The growing complexity of pension plan administration, caused by a series of federal laws and regulations enacted since the passage of ERISA in 1974, has discouraged employers from starting plans, especially defined benefit plans. We attempted to counter this trend with enactment of the SIMPLE plan in 1996. Yet substantial barriers to defined benefit pension plan formation still remain for small business.

For this reason, I introduced the defined benefit counterpart to SIMPLE, known as the Secure Assets For Employees Plan Act, or SAFE Plan Act, last May. This legislation creates a simplified, safe harbor defined benefit plan for employers with fewer than 100 employees. By making the benefit fully portable, requiring full funding each year, and creating one set of simplified actuarial rules, SAFE plans should prove popular both with employers and employees.

Opening Statement of Hon. Gerald D. Kleczka, a Representative in Congress from the State of Wisconsin

G. Klez

Rep. Jerry Kleczka
Way & Means Committee Statement
March 10, 1998

I am pleased Chairwoman Johnson has called this hearing on pensions today. This public debate will draw attention to some of the most important issues facing the Committee and American workers. I look forward to an update from David Strauss and the Pension Benefit Guarantee Corporation (PBGC) about their efforts to ensure that workers' pension plans will continue to provide them with financial security after retirement. I also look forward to the testimony of today's witnesses about the difficulties small business owners face when establishing pension plans for employees.

I hope that this hearing will address two important issues. First, health insurance for retirees. The steady decline in health insurance coverage for older Americans is one of the most dangerous trends confronting society today.

Second, we must examine the financial security of retirees. A generation ago, most retirees were guaranteed a pension income so they could enjoy a certain level of financial security in their golden years. Today, that is no longer the case. In fact, we have heard about many companies cutting their pensions in order to boost corporate profits. While these decisions may be perfectly legal, they are not responsible. Simply put, it is unfair to increase corporate profits at the expense of retiree pensions.

Approximately three million Americans between the ages of 55 and 64 do not have access to health insurance. While these individuals have less access to and face a greater risk of losing employer-based health insurance, they are twice as likely to have health problems than their younger co-workers. The direction of today's business climate is decreasing employer-based retiree health coverage. Unfortunately, the situation will get worse as millions of baby-boomers approach retirement age.

Diminishing health care insurance hit home for a number of my constituents in August 1996 when, in a bold display of corporate greed, the Pabst Brewing Company in Milwaukee coolly reneged on its promise to provide health benefits to nearly 750 retirees. These retired employees had not only received assurances from Pabst of adequate health care coverage after retirement, but also earned those benefits through long years of service to the company. Many of these retirees, in their early and late 50s, opted to retire before age 65. The hardhearted cancellation of these health care benefits left them vulnerable at a time in their lives when they are twice as likely to suffer medical problems. Now, these hard-working Americans await years of anxiety and uncertainty --- years of waiting to become eligible for Medicare, or years of paying exorbitant private health insurance premiums.

Unfortunately, thousands of workers and retirees across America have suffered similar benefit cancellations or health coverage reductions. John Morel, Hormel, and General Motors are just a few of the corporations who have left their retirees stranded without health insurance coverage. In 1996 only 40 percent of employers with more than 500 employees offered health benefits to early retirees, down 6 percent since 1994, according to the General Accounting Office (GAO). Even fewer small- and medium-sized firms offer retiree coverage.

In addition, retirees who lose access to employer-provided coverage must brave higher individual coverage costs, potentially less comprehensive coverage, and the risk of restricted coverage due to a pre-existing medical condition. For instance, some Pabst Brewing retirees whose health insurance was terminated by the company saw their annual insurance premiums jump from nothing -- not one dime -- to $4,500 for single coverage and $8,200 for family coverage.

Just as health benefits are no longer a guarantee, many retirees face a troubled financial future. The vast majority of retirees are struggling to make ends meet, and they depend on the pensions they earned while working to pay for living expenses such as rent, food, and transportation. Some companies, like Sears Roebuck and Company, decided the loyal service of their employees should not be rewarded with a pension check upon their retirement.

A few months ago, Sears announced a drastic decrease in retiree life insurance contracts. Employees, who had counted on these life insurance contracts to provide a steady income in their retirement years, were informed that their contracts would be reduced to $5,000 over the next 10 years, regardless of the amount the employee paid into the contract. Regrettably, American business can reduce or eliminate benefits under the guise of a "reasonable business decision."

Many corporations argue they need to cut employee and retiree benefits to protect their bottom line. But what about the bottom line of their retirees' checking accounts? These are people who have worked hard day after day and, in return, expected some compensation for their efforts. I hope the hearing today will focus public and Congressional attention on the unfair treatment of retired workers and provide new ideas to prevent the continued erosion of employee benefits.

Again, I would like to commend Chairwoman Johnson for scheduling this important hearing. While there is a lot of good news about pension plan solvency and expanding employees' pension coverage, there is also some bad news about the future health and financial security of retirees. I predict these problems will only get worse over time as more and more businesses focus on corporate profits, rather than on fulfilling promises made to loyal employees. I look forward to hearing the testimony of the witnesses and hope they can shed light on these important issues.

Mr. PORTMAN. Mr. Strauss, thank you very much for your testimony, and we appreciate your comments, particularly on some of the legislative proposals that are before us. On SAFE versus SMART, just one simple question. Do you think we can reconcile the differences between these two, or should we be looking at two separate defined benefit plans and moving forward and offering, therefore, more options?

Mr. STRAUSS. I think that they serve different purposes and work well in combination with each other.

Mr. PORTMAN. So you're suggesting that perhaps this Subcommittee look at enacting both proposals—pushing both proposals forward?

Mr. STRAUSS. I'm sorry. We're talking about SAFE and SMART rather than SIMPLE and this defined benefit concept?

Mr. PORTMAN. Right. I'm talking here about the administration's proposal, which is the SMART plan, and Chairwoman Johnson's proposal, which is the SAFE plan.

Mr. STRAUSS. I think that since the SAFE and SMART plans contain many of the same features that it should be easy to work out our differences.

Mr. PORTMAN. We should give directives on them.

Mr. STRAUSS. Yes, sir.

Mr. PORTMAN. That certainly would be my hope, and then we would have one—one—vehicle for smaller businesses on the defined benefit side and one on the defined contribution plan, the SIMPLE plan.

Does it make sense, my second question would be, to reconcile some of the differences between the SIMPLE plan and the SAFE plan or the SAFE/SMART plan? As I read the SAFE plan, it seems to have many of the same criteria, which I like. Many of the same definitions, which I think is very helpful. But do you think that there is a need to try to present one single, coherent pension vehicle, or should we be providing these two separate options?

Mr. STRAUSS. Again, the differences between SIMPLE and the SAFE/SMART proposal—I think that the SIMPLE and the defined benefit proposal serve different purposes. And for older workers—like my father, for example—there is not enough of a window for them to save enough, early enough——

Mr. PORTMAN. Under the SIMPLE plan.

Mr. STRAUSS [continuing]. To guarantee them a set benefit for life. And so I think that these vehicles serve different purposes, but I think they work well in combination.

Mr. PORTMAN. But you would hope that a smaller business would be able to offer both of these options and some workers would want to pick up both?

Mr. STRAUSS. What we're trying to do here is to provide the option for those small businesses who are looking for more choices to have the option to provide a true defined benefit plan if that's something that they think works for their workers.

Mr. PORTMAN. In your statement, you said that you thought that these small business plans should be insured through the PBGC and you said that the premium might be less because you thought that they might offer less risk. I would say that there is less risk in these plans certainly, and I wondered if you could give us a sense of what the premium might be?

Mr. STRAUSS. I've recommended $5 for the premium.

Mr. PORTMAN. Five dollars versus roughly $19?

Mr. STRAUSS. Nineteen dollars, which is the flat rate premium for the single employer plan.

Mr. PORTMAN. One other general question I have, then I want to get to my colleagues. Maybe we'll have time to come back and talk about some other issues. But on the issue of PBGC generally, in your testimony you didn't address the issue of premiums directly.

You do have a surplus. I want to commend you for that, and I guess we should commend our economy for that. And it is on a sound financial basis. The question is, when you have a surplus, how much of a cushion is necessary for what you described in your testimony as an economic downturn that might occur. What's your present thinking of how much of a surplus the agency should maintain before we begin to look at the issue of premium discounts or premium reductions?

Mr. STRAUSS. I think it's important to point out, at the outset here, that we've only been operating in the black for 2 years out of the 24 years that we've been in existence.

Mr. PORTMAN. You've done better than the Congress. We spent almost 30 years trying, and haven't gotten there yet. But go ahead.

Mr. STRAUSS. And I think that, in order to determine how much of a cushion is enough, it requires us to look at all of those factors that influence our bottom line. So premium levels would be one factor. Our investment strategy would be a factor. The interest rates that we use to evaluate the liabilities of the plans that we insure is another factor. And so, we're just at the beginning of that process right now. But I don't think that a 2-year snapshot is an adequate basis on which to make long-term decisions about the appropriate premium level. And I think that we need to be prepared in the event of a downturn. When we look at this 2-year snapshot, we're looking at very ideal conditions. The economy is doing very well. Our PBGC investments are doing very well. There have been very few large plans that have terminated. And I think that we just need a longer horizon on which to base a judgment about adjusting premium levels. I don't think that every time there's a slight change, there should be an adjustment in the premium levels.

Mr. PORTMAN. Let me push you just a little further on that. Can you give us a sense of whether that's 5 or 10 years, and or what the surplus level might be as a percentage perhaps?

Mr. STRAUSS. I think that there's one other point that I should make with respect to premium levels. Because of the provisions in RPA, from 1994, with the stricter funding provisions, the variable rate premium stream is already coming down. And in the year 2000, when the variable rate premium is based 100 percent of the 30-year Treasury rate, it will roughly cut the variable rate premium in half. So a premium reduction is already occurring. Also with respect to the flat rate premium—the flat rate premium was set at $19 in 1981—or 1991, I should say. And so, if you just look at the impact of inflation on that, there's been a 15- or 20-percent reduction there. So, I think that all of those factors will need to be considered, and we have more sophisticated models that we're developing now to help us in this respect. And if I come back next year, I can give you much better answers to this question.

Mr. PORTMAN. I will push no further. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Director, I wonder if you could touch on what the biggest challenges facing you and the Pension Benefit Guaranty Corporation is today?

Mr. STRAUSS. I think that the biggest challenge is to make sure that we have an adequate cushion to protect the agency in the event of an economic downturn. That is, as I indicated, when you look at our history, we've only been in the black for 2 years out of 24 years. And that in order for the plan sponsors and the participants whose benefits we insure to have confidence in the system, I think that it's important that we maintain an adequate cushion to protect the agency in the event of an economic downturn. If an economic downturn occurs, there will be significantly more plans terminating and the PBGC assets will be worth less. And so, that's the eventuality that I think we need to be prepared for, and I think that that's our biggest challenge.

Mr. COYNE. I wonder if you could try to give us some idea of why employers are beginning to steer away from defined benefit pension plans and instead setting up defined contribution plans?

Mr. STRAUSS. I think that the reasons that the employers are steering away from defined benefit plans are basically three.

They're concerned about the complexity of those plans. They're concerned about the high administrative costs, and they're concerned about unpredictable funding levels. And I think that all of those issues are addressed by the SAFE/SMART vehicles that this Subcommittee is considering.

Mr. COYNE. What did PBGC do administratively to get the agency off the Federal Government's high-risk list?

Mr. STRAUSS. Well, I think that when you look at the improvement in our financial condition that it's basically threefold. I think the reforms that were passed in 1994—that provide for stricter funding limits, the participant notification provisions, taking the cap off the variable rate premium—are one set of factors that have had a positive impact on our bottom line. We've also done enormously well off of our trust fund investments. That's had a positive effect on our bottom line. And I think that those have been the major factors—that coupled with the improvement in the economy overall—that result in our condition being vastly improved.

Mr. COYNE. Thank you very much.

Mr. PORTMAN. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman. And I'd like to say, Mr. Strauss, we appreciate your being here. I have a couple of specific questions that I wanted to vent with you to improve my understanding.

First, in your view, what is the likely level of risk for a defined benefit plan maintained by a small versus a large business?

Mr. STRAUSS. Well, I think, when we look at the vehicles that the Subcommittee is considering here, that because of the particular design of these plans the risk would be very small. And so, it's a design that's not very risky, and there are small amounts of money involved here. So the combination poses very little risk to the PBGC.

Mr. ENGLISH. With regard to the SMART plan, I think that other witnesses today intend to take issue with limitations on compensation for determining an individuals annual benefit, which I think is established in that proposal at $100,000. Why do you consider this to be an important positive attribute of the President's plan, if you do?

Mr. STRAUSS. Well, in developing our plan, we attempted to target that part of small business where the coverage was the poorest, and the costs were the highest. And so that was our primary focus. But, I would be happy to look into any issues that you would like to raise in this respect.

Mr. ENGLISH. Well, I hope you'll have an opportunity to review some of the other testimony that's coming before us today, because I think some of it speaks directly to that. My final question: You indicated in your testimony that with the SMART plan the small business participating may have to contribute extra funds if the participant chooses an annuity form of benefit in the SMART Trust. The SAFE plan, as I recall, does not include such a provision because of concerns that this possible additional liability might discourage small businesses from participating under the terms of this plan. A small business has limited purchasing power when buying an individual annuity contract. If we followed the SMART plan approach here, would the PBGC be willing to consider developing methods by which small businesses adopting the plan could purchase annuities which would be more competitively priced?

Mr. STRAUSS. I'm aware of the issue that you raise, and it's something that we're looking into and that we're attempting to address. Yes, sir.

Mr. ENGLISH. Thank you. Well, in that case, we'll look forward to the end result of your efforts.

Mr. Chairman, I appreciate the chance, and I'll yield back the balance of my time.

Mr. PORTMAN. Thank you, Mr. English.

Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Mr. Strauss, how large is the surplus that you're talking about today, in dollars and cents?

Mr. STRAUSS. One week from Monday we will release our annual report for last year, and that will give you an accurate number with respect to our surplus. It's going to be released 1 week from Monday.

Mr. KLECZKA. OK, what is the ballpark on that number coming out?

Mr. STRAUSS. I think that, while the auditors and the lawyers are going over the number, the best answer that I can give you is that clearly it's going to be a positive number, and we can release the exact number 1 week from Monday.

Mr. KLECZKA. OK, now this is your second year of a surplus?

Mr. STRAUSS. And this will be our second year of a surplus, yes, sir.

Mr. KLECZKA. What was the surplus last year?

Mr. STRAUSS. Sorry.

Mr. KLECZKA. What was the surplus last year?

Mr. STRAUSS. $869 million.

Mr. KLECZKA. OK, and you assume that we're going to have another surplus this year?

Mr. STRAUSS. Yes, sir, it will be a larger number, I can assure you of that.

Mr. KLECZKA. That was my next question.

Mr. STRAUSS. Thank you.

Mr. KLECZKA. OK, so it would be more than $869 million or would it be lower than that amount?

Mr. STRAUSS. No.

Mr. KLECZKA. OK, that's clearly good news because we've been working with PBGC for years. Every time you've appeared before the Subcommittee—or your predecessors—it was always to indicate the bad news and this Subcommittee had to either adjust the premium or do other things to make the fund solvent.

Are we still experiencing problems with the big four industries in this country, that is, steel, airlines, tire rubber, and auto? Are we still seeing underfunding in those segments of our economy?

Mr. STRAUSS. Yes. Generally, the answer is yes.

Mr. KLECZKA. So, if in fact, we would see a downturn in the economy of any prolonged degree, we would probably see problems in those four areas; thus, that surplus would be gone in a short while, as I understand it. Is that not somewhat accurate?

Mr. STRAUSS. It's entirely possible. And so when you look at the surplus in terms of our large plans that have terminated historically, the surplus would equal three or four of the large terminated plans.

Mr. KLECZKA. OK. So before we start talking about reducing premiums, let's just hold on and see what happens to the economy on a longer basis, knowing very well that there are still a lot of large plans that are underfunded. And actually, the large plans tend to be the problem plans, not the small business plans like my friend Congressman English talks about. Small business plans usually do not pose a big liability problem even though they might have some problems. Is that somewhat accurate?

Mr. STRAUSS. Yes. It is.

Mr. KLECZKA. OK, let me ask you, in the past you produced a list of 50 major corporations in the country who had severely underfunded pension plans. Do you not publish that list anymore?

Mr. STRAUSS. We did away with the top 50 list because we were singling out companies that were meeting all the legal requirements that did not necessarily pose any risk to the participants in their plans or to the insurance program. I think that here's an example of where the new tools that we were given in the 1994 law are working. So the stricter funding limits, the participant notifications, which I know that you're very familiar with, where there is a very high threshold. If a plan is less than 90-percent funded, then the plan sponsor has to inform every single participant. When you look at the plans that we've taken in historically at the PBGC, only 2 percent of them have been funded more than 75 percent. So this is a very high level—a very high threshold—at which participants are notified. And so I think that because of this better tool, it made the top 50 list less necessary.

Mr. KLECZKA. But publishing the top 50 list did not mean that these 50 major employers of the country were deficient in their payments or whatever. It's just that the plan was underfunded. And I think the 1994 law, as you indicated, helped promote more—or a better—level of funding of plans.

Now part of that law, as you indicated—and let me just ask you to expand—was a notification to employees who have a definite part in this whole program and that notice was to provide an English—simple English—explanation to employees that their plan was somewhat underfunded. Is that being accomplished and what is the result of that?

Mr. STRAUSS. It's being accomplished. It's working well. Many of the plans are using the model notice that we provided. There have been a significant number of cases where plans have funded up to the 90-percent level so they don't have to send out the notice. And so, we know that that's working very well. We continue to monitor it and think it's a great success story.

Mr. KLECZKA. I think it's an important part of that law because at least it gives the employee the heads up that there could be a problem. Prior to that law change, the only time they received notice of a problem with their plan is when they received a notice from the PBGC indicating that you were taking over the pension plan.

One last question, Mr. Chairman, if I might. Even though your agency has no responsibility over retiree health plans or retiree benefits in the life insurance area, there was some thought on the part of this Member of Congress to expand at least the health area because of a problem we had in Milwaukee with the Pabst Brewing Company. More recent, many of us are receiving letters and calls from Sears' former employees because Sears is planning on reducing dramatically the life insurance benefit that they had promised to their employees. Now, it's not a responsibility of yours; but nevertheless, is there any problem with the funding or the balances in the Sears retirement program, so these retirees might receive another notice from you or from Sears that there's now a problem with the retirement benefit?

Mr. STRAUSS. I'll be happy to check that for you and get back to you on that.

Mr. KLECZKA. OK, I'd appreciate that because we are receiving letters from constituents.

[The following was subsequently received:]

Funding Level of the Sears Retirement Plan

The principal defined benefit retirement plan of the Sears, Roebuck Co., as of January 1, 1996, the latest available data, was 80 percent funded. The plan had $1.8 billion in assets and $2.2 billion in liabilities. The plan was then paying benefits to 32,000 retirees. It had 154,000 active participants and another 41,000 vested participants who were no longer employed by the company.

Mr. KLECZKA. Thank you, Mr. Chairman, for your indulgence.

Mr. PORTMAN. Mr. Tanner.

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

Mr. Strauss, thank you for being here. I read with great interest your statement. I only have one question. You talk about the fact that only 20 percent of workers within firms with fewer than 100 employees have some sort of pension coverage. You talk about the SAFE and SMART plans and go on to say that "PBGC cannot guarantee these plans without insurance premium; however, because these plans, by their design, may pose less risk, we propose that they pay a substantially reduced premium." Could you expand on that idea, please?

Mr. STRAUSS. I think that, with respect to the PBGC premium—from some of the discussions that I've had with the pension professionals who would actually be marketing these plans, they feel that having a plan that's insured by the government will make it more marketable. And as long as we can keep the premium modest, the PBGC insurance would actually add value to them and make it easier to sell these things.

Mr. TANNER. You haven't fleshed that out. It's just that the marketing aspect of it is the driving force?

Mr. STRAUSS. Well, what we've tried to do is to work with the practitioners who are actually going to be selling these things, to get a sense from them what sort of vehicle makes sense. And I can recall a discussion that I had with one benefits consultant where he said that the typical small business that would be interested in something like this was a small business that has matured to some extent, where the owner of the business has a corps of longtime, loyal employees and that we have to create incentives for that owner and for that corps of longtime employees to get them to think about offering this sort of defined benefit pension plan.

The advantage of creating those incentives and getting them to consider a plan like this, as I indicated earlier—I was talking about the situation of my father who, very late in life, got a job when he was working as a janitor that was covered by a defined benefit pension plan where, because of that, he now has a small amount of guaranteed income that he can look forward to for the rest of his life. And so, what we're trying to do here is to create incentives for the average small business owner who makes about $55,000 a year to offer the sort of defined benefit plan that will benefit him, the corps of workers who've been with them for a long time, but also the low-paid workers like my father.

Mr. TANNER. OK. I follow, you.

Thank you, Mr. Chairman.

Mr. PORTMAN. Thank you.

Mr. Strauss, just a couple of followup questions. First, to your line of questions with Mr. Tanner. It seems to me that it would make sense for the SAFE plan—for the SAFE/SMART plan, however it comes out—I wonder if there's a way that we can combine those two acronyms to track as closely as possible the outlines of the SIMPLE plan. And I think it's fair to say that the SIMPLE plan has caught on. It's being explored, certainly by a lot of small businesses in my district. I know it's selling like hot cakes. But one of the things I noticed, as I looked today at the testimony, is that whereas, the SAFE plan, again, tries to follow the criteria and the definitions as closely as possible and also the compensation levels as closely as possible, the SMART plan imposes some lower limits. In particular, under SAFE, the annual compensation which can be considered under the plan is the same as it is under SIMPLE—$160,000. And SMART has a lower limit. I assume that's targeted more toward folks who really need it and people at the low-income levels. Do you think that that lower limit is going to discourage some adoption of the plan and shouldn't we be, as I stipulated earlier, trying to keep this as simple as possible so that the two plans have as much as possible the same criteria?

Mr. STRAUSS. We certainly agree about the need to keep it as simple as possible and make it as easy to administer as possible. Regarding the pension professionals that we deal with, the significant issues that they raised are that they are concerned about complexity of these programs, and they're concerned about the steep administrative costs. And so, that's clearly what we're trying to address here, and to do it in a way that the net result is a predictable, secure benefit for life. And so, those are the objectives that we're working toward.

What we focused on here is that part of small business where the coverage is the lowest, where the costs were the highest. We're willing to expand that dialog with you.

Mr. PORTMAN. All right. So there's some flexibility there, and we have the same goal in mind which is to keep it as identical as possible to the other criteria.

Jumping to another issue quickly—multiemployer plans. I know you've got a lot of different areas that you have to look into, and this is one of them. I think there are about 2,000 multiemployer plans out there that are under your purview. And about 50 or so that are underfunded.

Having heard about this from my district where we've got one of these underfunded plans—their concern is that plan trustees are granting benefit increases in these plans even though they again are chronically underfunded and increasing the liability even though there is no control over the situation by the employer. Is there a way to address this? Maybe by designing a solution that only affects the underfunded plans? Making sure a plan is adequately funded before there are new benefit increases? Have you focused on this area? Do you have any suggestions as to how to address the problem?

Mr. STRAUSS. I haven't focused on this area. I can tell you that overall the system is sound—we're required by law to do a 5-year study. That in the last 5-year study, the funding level of these plans overall was shown to be improving, that out of these 2,000 plans, we've only taken in—I think—19 in our entire history. Under this program, unlike the single employer program, we've been reporting a surplus since 1981.

Mr. PORTMAN. Right.

Mr. STRAUSS. And so I'd be happy to look into your specific questions and get you the answers.

Mr. PORTMAN. OK. Mr. Kleczka, do you have any additional questions?

Mr. KLECZKA. Yes, Mr. Chairman. Thank you very much. Mr. Strauss, one of the ideas I had and wanted to share and get your reaction was to expand the area of responsibility for the Pension Guaranty Corporation and either change the name to reflect Pension and Benefit Guaranty Corporation or Pension and Healthcare Benefit Guaranty Corporation I'm thinking now of a situation in my district with the Pabst Brewing Company, wherein they promised early retirees and regular retirees healthcare benefits. Then 1 day, with no notice to its retirees, Pabst Company was no longer going to provide benefits to its retirees. These people were left high and dry. For the ones who were over 65, we did pass legislation in the last budget bill which waived the penalty for these folks getting into Medicare. Prior to that, there would have been a financial penalty for those folks. But for other employees, especially those in their fifties, there was no place to go except to the private market, and if there were any preexisting conditions, these employees were faced with a very, very high premium.

Now for companies that offer and give health care benefits, I would like to get your thoughts on the possibility to provide a similar system like we do for the pensions where there would be a small premium paid into your agency to cover those employees who would lose their health benefits which were part of their retirement plan. Knowing full well that a pension is very, very important in your later years, but so is health care coverage. If you made your retirement decisions based on the probability or the guarantee that your employer is going to offer them and suddenly its taken away—you're in some difficult straits.

So the question is, what would be your reaction to expanding the PBGC to include not only pensions but also benefits that were guaranteed and provided by the employer, like health?

Mr. STRAUSS. As tempted as I am to expand my mandate here a little bit this afternoon, I'll be happy to look into those issues for you and get back to you. I'm aware of your concerns and we can look into them.

Mr. KLECZKA. What would be your reaction to having this additional responsibility?

Mr. STRAUSS. I think that there's an agency within the Department of Labor—the Pension Welfare Benefits Administration—that has primary jurisdiction in this area——

Mr. KLECZKA. Well, in the situation with the Pabst Brewing Company went to them and they had no authority over the situation either. So that clearly is not the backup agency to protect employees' benefits.

Mr. STRAUSS. I'll be happy to look into this some more and get back to you on it.

Mr. KLECZKA. Thank you.

[The following was subsequently received:]

The Administration is very concerned about the plight of retirees when an employer drops their health insurance coverage. The termination of health benefits can be especially serious for pre-Medicare eligible retirees who may find it impossible to obtain affordable coverage elsewhere. However, we do not believe the answer to this problem is for the Pension Benefit Guaranty Corporation to insure retiree health benefits.

In the absence of comprehensive health reform, a federal guarantee of retiree health benefits is not practical and would potentially create an open-ended liability for the United States Government. Retiree health benefits are very different from defined benefit pension plans. Unlike defined benefit pension plans, it is very difficult to accurately determine present value of benefits in a particular case. Retiree health benefits are typically not funded in advance, not vested, and are often terminable at the discretion of the plan sponsor. The benefit terms can also differ widely, with differing employee contribution levels, co-payments, and other benefit and treatment provisions. The potential liability associated with these benefits can vary widely depending on the terms of the plan, and assumptions of health costs and technology growth.

Providing a Federally guaranteed retiree health benefit program in the absence of more comprehensive plan standards could actually encourage termination of these health plans. It would subsidize employers who break their promise by taking over their benefit payments for them. The PBGC guarantees payment of promised pension benefits when employers in financial distress are unable to fulfill those promises.

The Administration believes employers must clearly state the terms of their retiree health benefit promise, and be held accountable to that promise. Too often, employers have been able to cut retiree health benefits under fine-print technicalities or disclaimers in their plan documents, even though they are contrary to assurances of coverage they have made to their employees and retirees. The Administration has aggressively intervened in litigation in these cases by filing amicus briefs supporting the rights of retirees to be heard and for preserving the health benefits of retirees involved.

A more practical and less disruptive approach than a Federal guarantee is to provide retirees the opportunity to obtain affordable health coverage, especially where their benefits have been terminated. The Administration has recently proposed legislation to require that retirees age 55 or older whose benefits are terminated be allowed to buy into their former employers' plans for active employees at a price not greater than 125% of the average cost for the group. The legislation would offer retirees who lose benefits access to affordable coverage until they become eligible for Medicare. It would also limit employers' ability to walk away from their obligations to their retirees.

Mr. PORTMAN. Other questions.

[No response.]

Mr. PORTMAN. Mr. Strauss, thank you very much. We'd look forward to working with you on "SIMPLE," "SAFE," and "SMART," and other ways to expand retirement savings opportunities. We'd like to call our next panel now. Mr. Strauss, thank you very much for your testimony this afternoon.

Our next panel consists of a number of experts in the pension area. Ron Merolli, who's director of Pension Legislative and Technical Services, National Life Insurance Co., Montpelier, Vermont. He's here on behalf of the American Council of Life Insurance. Gregory Moore, deputy director of the Pension Rights Center. James V. Leonard, vice chairman, Engineering Employment Benefits Committee, on behalf of the Institute of Electrical and Electronics Engineers of the United States. Gail S. Shaffer, who's executive director of Business and Professional Women/USA. Michael E. Callahan, who's president of PenTec, Inc., Cheshire, Connecticut, on behalf of the American Society of Pension Actuaries. Gregory J. Fradette, Sr., the agency principal of the Greg Fradette Agency, Inc., of Bristol, Connecticut.

Are you all situated? Mr. Merolli, we'd like to start with you this afternoon, if we could. Your full statements can be made part of the record. We ask you to summarize your oral remarks in 5 minutes. So you'll see the green light come on and then moving to the orange and finally to the red after 5 minutes. We ask you to keep your formal presentation to those 5 minutes, but would be happy to add anything else to the record. Mr. Merolli.

STATEMENT OF RON E. MEROLLI, DIRECTOR, PENSION LEGISLATIVE AND TECHNICAL SERVICES, NATIONAL LIFE INSURANCE CO., MONTPELIER, VERMONT; ON BEHALF OF AMERICAN COUNCIL OF LIFE INSURANCE

Mr. MEROLLI. Thank you, Mr. Chairman. My name is Ron Merolli of National Life Insurance Co., Montpelier, Vermont. I'm speaking today on behalf of the American Council of Life Insurance, ACLI. ACLI is the major trade association of the life insurance industry. We are very concerned with issues involving the continued viability and expansion of our retirement system. We would like to express our appreciation to the Subcommittee for inviting us to share our views and those of the other speakers on the obstacles facing small employers who wish to establish retirement programs, and on a retirement program that hopefully will overcome many of those obstacles. We have also submitted written testimony for the record.

We have been involved in assisting small businesses in fulfilling their retirement objectives for many years and fully appreciate their obstacles. For years, the incentives for establishing retirement programs have been eroded by almost annual legislation that used our pension system to raise revenue to pay for unrelated programs. The constant burden of complex regulations and ever-tightening restrictions in order to meet short-term revenue objectives historically discouraged small business participation. As a result, plan formation, particularly in the defined benefit arena, declined significantly. Small businesses often do not have the financial resources to hire high-priced consultants to design or maintain their plans. Therefore, it's critical that their pension expenses be used primarily for providing retirement income.

In the last several years, the Small Business Job Protection Act of 1996 and the Taxpayer Relief Act of 1997 brought changes that are very favorable to individual savers and to small businesses. We're very happy that there is strong bipartisan support for reforms, particularly in a simplified, defined benefit type program for small business owners. We are particularly interested in and support the concept contained in H.R. 1656, the Secure Assets for Employees Plan Act of 1997, the SAFE Plan, and identical legislation contained in both S. 883 and S. 889.

SAFE will encourage small businesses to adopt defined benefit plans. We also believe SAFE is superior to the SMART plan proposal which is included in the administration's fiscal year 1999 proposed budget as we will discuss later. SAFE can be either an annuity or a safe trust. The ACLI supports permitting all types of business entities to participate in SAFEs—including corporations, non-profits, governmental units and other unincorporated entities—similar to how SIMPLE is handled. Under SAFE, each year the employer contributes the amount necessary to fully fund a benefit for any current or prior year of service that is earned by the employee in that year, provided the employee earns at least $5,000 in compensation, whether or not the employee is working on the last day of the year. To accomplish this, the proposal uses age 65 as the retirement age. Current mortality and expense assumptions are used and the funding of benefits are determined assuming a 5-percent rate of return.

However, while we favor SAFE, we are concerned with that 5 percent guarantee. We feel there should be a reasonable range of 3 to 5 percent. If the basis for the guarantee is 5 percent, insurers will need to make long-term investments that have yields higher than 5 percent in today's very low interest rate environment. If interest rates drop further, 5 percent causes financial difficulties. The trend is down and 5 percent could put insurers at long-term risk. We are conservative investors—investing mainly in high-quality bonds and mortgages. The interest earned on the investments is competitive. Therefore, to guarantee an interest rate for the long term of 5 percent—when long-term rates are currently hovering at less than 6 percent and where they could decrease to less than 5 percent, raises serious concerns. If rates are declining, this may tempt insurers to take more credit risks.

A SAFE annuity is approved by each State and their primary concern is how products impact a company's financial bottom line. It may be tough to get a product approved in a State with a long-term guarantee of 5 percent. Also based on an informal survey, we found no company that currently guarantees 5 percent. The full guarantee should be historically sustainable which it would be at 3 percent—that's what most companies guarantee.

What we could do though is offer 3 percent and also use products where employees share in the investment returns of the insurer's general account. The SAFE annuity contract holder could do better in years when returns are better.

We do not feel that PBGC insurance is needed for SAFEs. SAFES are always fully funded and there's no need for PBGC coverage. We also feel that SAFE plans should be fully portable. We are encouraged that there's bipartisan support for a simplified defined benefit plan. However, we feel that the SAFE plan is superior to the SMART plan.

SMART, which uses a trust only, and not an annuity, specifically excludes professional service employers. It can't be established if the employer maintained another defined benefit plan in the last 5 years. Matching contributions will be limited to 4 percent. It unnecessarily requires PBGC premiums. It doesn't allow past service credit—which I think is very important for 50-year-old employees who wanted to make up time to get their plans funded in time for their retirement, it uses an unrealistic $100,000 compensation maximum, and it has a low-benefit percentage. In addition to SAFE, there are other proposals that we support as well—including relaxing the top-heavy rules, repeal of the 150-percent current liability funding limit—and others.

We applaud Congress and the administration for embracing the concept of a simplified defined benefit approach and we promise to work diligently with you to implement a workable program. Thank you very much.

[The prepared statement follows:]

Statement of Ron E. Merolli, Director, Pension Legislative and Technical Services, National Life Insurance Co., Montpelier, Vermont; on Behalf of American Council of Life Insurance

My name is Ron E. Merolli. I am Director of Pension Legislative and Technical Services for National Life Insurance Company at the Home Office in Montpelier, Vermont. I am speaking today on behalf of the American Council of Life Insurance (the ACLI).

The ACLI is the major trade association of the life insurance industry, representing 532 life insurance companies. These companies hold 89% of all the assets of the United States life insurance companies and 90% of the insured pension business. With such a large commitment to the retirement security of millions of Americans, the insurance industry is vitally concerned with issues affecting the continued viability and expansion of the nation's private retirement system.

I would like to express our appreciation to the members of the Committee for inviting us to state our views on the obstacles facing small employers who wish to establish retirement programs and on an exciting new retirement program that hopefully will overcome many of those obstacles.

My company and other ACLI member companies have been deeply involved in assisting small businesses in fulfilling their retirement objectives for many years. Thus, we have a full appreciation of the difficulties small businesses have faced in meeting those objectives. These small businesses have had to wade through minefields of complex tax and labor laws and regulations. For many years, the incentives for establishing retirement programs have been eroded by almost annual legislation that used our private pension system to raise revenue to pay for unrelated programs. Legislation was crafted not to enhance retirement security for present and future generations, but as a way to offset non-related federal expenditures to meet budget goals. The constant burden of complex regulation and ever tightening restrictions on contributions and benefits in order to meet short term revenue objectives has historically discouraged participation by many small businesses in the private pension system. As a result, qualified retirement plan formation, particularly in the defined benefit arena, has declined significantly.

Qualified plans are costly for small businesses, that often do not have the financial resources to hire high priced consultants to design and maintain their plans. The reporting, disclosure, and administrative requirements imposed by federal laws and regulations are very complex, which often has translated into increased costs that are too burdensome for many small employers to absorb. It is critical that the small business owner's pension contributions are used primarily for providing retirement income to retirees and not for administering the plan.

However, with the passage of the pension and benefits provisions of the Small Business Job Protection Act of 1996 (SBJPA96) and the Taxpayer Relief Act of 1997 (TRA97), small businesses finally had something to cheer about! The onerous family aggregation rules and the Code section 415(e) combined plan limits were repealed, 401(k) plan testing safe harbors and other simplifications were enacted, the highly compensated employee and compensation definitions were simplified, various reporting and disclosure rules were eliminated, traditional IRAs were enhanced and the new ROTH and SIMPLE IRAs were created, to name but a few of the changes favorable to both individual savers and to small businesses.

Nevertheless, much work still needs to be done, and we are very encouraged that there is strong bipartisan support for additional pension reform initiatives, including specific initiatives for small businesses, particularly in one area where the need is greatest. (We list other measures we believe will encourage small businesses to adopt and maintain pension plans at the end of the testimony.) While many of the recent enhancements have focused on "defined contribution type" programs such as SIMPLE, SEPs, and various types of profit sharing plan designs, one area that still needs addressing is the concept of a simplified "defined benefit type" program for small business owners. Small business plan coverage is still woefully inadequate and defined benefit plan coverage is still shrinking. Therefore, it's encouraging that both Congress and the Administration have embraced the view that what's needed now is a new simplified, tax favored defined benefit type retirement plan to complement the already established SIMPLE defined contribution plan.

We have examined several proposed plan designs, and we are particularly interested in and support the concept contained in H.R.1656, the "Secure Assets For Employees (SAFE) Plan Act of 1997" and in the identical legislation contained in both S.883 and S.889. The ACLI believes that SAFE will encourage small business employers to adopt defined benefit plans and reverse years of defined benefit plan erosion. We believe the SAFE plan is superior to the Secure Money Annuity or Retirement Trust (SMART) plan proposal as included in the Administration's fiscal year 1999 proposed budget, as we will discuss later. The ACLI supports expressly permitting all types of business entities to participate in SAFE plans, including corporations, S corporations, non-profits, governmental units, and unincorporated partners, sole proprietors, and owner employees. We do have one major concern with the SAFE proposal.

The ACLI is concerned with the requirement in H.R.1656 that a 5 percent interest rate be used in computing the amount required to be contributed by an employer each year under a SAFE Annuity. We believe that the legislation should provide for a reasonable range of interest assumptions of 3 to 5 percent that can be used to fund benefits.

If the underlying interest basis for the guaranteed retirement benefit is 5 percent, insurers will need to make long term investments that have yields in excess of 5 percent, which is difficult in today's low interest rate environment. Moreover, if interest rates were to continue to drop in the future, the 5 percent guarantee could cause insurers financial difficulties. Although no one can predict how interest rates will move, it is interesting to note that the annual change of the net rate of return on the general account assets of insurance companies over the past ten years has been negative 2.2 percent, and for 1995–96 was negative 1.9 percent. The trend is clearly down and the 5 percent interest rate guarantee could put insurers at considerable risk for the long term.

Our industry recognizes that our annuity products are designed to provide long term financial protection and security. We are conservative investors, investing mainly in high quality bonds and mortgages, and the interest earned on these investments is competitive. Therefore, to guarantee an interest rate for the long term (5 percent), when long term rates are currently hovering at less than 6 percent and where the very real possibility exists that they will decrease to less than 5 percent, raises serious concerns for our industry. Moreover, a SAFE Annuity will have to be approved by each state's insurance commissioner, and their primary concern is how any new product impacts a company's financial condition. Companies may very well have difficulty getting a product with a long term guarantee of 5 percent interest approved in the states in which they do business. Also, based upon an informal survey of various annuity providers, we found no company that currently guarantees a 5 percent interest rate. The floor guarantee should be at a rate which is reasonable to believe will always be sustainable based on historical records, which is 3 percent. That is the floor rate that most companies are currently guaranteeing in their products.

If it is felt that a 3 percent guarantee is too low, the other option is to allow employers to choose a participating SAFE Annuity. Such a product could offer a 3 percent guarantee and provide the employees an opportunity to share in the investment returns of the insurer's general account, thereby assuring that the SAFE Annuity contractholder could do better than the guaranteed rate of return in years when the general account returns are better.

PBGC Insurance

The Council agrees that PBGC insurance coverage should not be required in any SAFE plan. A SAFE Annuity is a fully annuitized defined benefit, and consistent with present law annuity rules, should be exempt. The cost of PBGC insurance coverage is an additional expense that often makes defined benefit plans unaffordable for many small employers.

Portability

Since each participant's benefit is kept in a separate account, all benefits in all SAFE plans are fully portable. Portability of pension assets is critically important. The small business area is where many employees enter the job market, where many new jobs are created, and where substantial turnover occurs. Ease of movement for SAFE plan assets is a big plus.

SAFE and SMART

As mentioned earlier, the Council is encouraged that there exists strong bipartisan support for a tax favored simplified defined benefit program for small businesses. We have examined the alternative proposed by the Administration (The Secure Money Annuity or Retirement Trust (SMART)), and we believe that SAFE is the better option for the following reasons.

1. SMART specifically excludes professional service employers from establishing a plan, prohibits an eligible employer from establishing a plan if the employer maintained another defined benefit plan in the last 5 years, and limits matching contributions to 4% if SMART is maintained with a 401(k) plan.

These rules are counterproductive to new plan formation and will discourage participation in plans.

2. SMART would unnecessarily require a PBGC premium for trusts (albeit less than for other defined benefit plans. SAFE imposes no such requirement.

3. SMART does not allow for any past service credit. SAFE does and this is a very attractive feature for small business owners.

4. SMART uses an unrealistic $100,000 compensation maximum. SAFE uses the current law qualified plan limit of $160,000 (indexed).

5. SMART's minimum defined benefit is only 1 or 2 percent, increasing to 3 percent only during the first 5 years of the plan. SAFE's benefit formulas are more realistic.

In closing, the Council believes that SAFE is an important step towards expanding retirement plans for small businesses, we believe that small plan formation will increase if SAFE is adopted.

In addition to the SAFE proposal, we believe the following list of pension proposals will greatly simplify the pension rules for plan sponsors, particularly small businesses, and thus will lead to expanded pension coverage for employees.

A. Relax top-heavy rules

1. Repeal family attribution applicable to top-heavy rules
2. Employee deferrals not counted for purposes of top-heavy rules
3. Matching contributions satisfy top-heavy minimum contribution requirements

4. All 401(k) safe harbor plans deemed to satisfy top-heavy rules

B. Complete repeal of the 150% of current liability full funding limit

C. Allow plan loans for self-employed individuals

D. Repeal age 70 minimum distribution requirement for small business owner-employees (5% owners)

E. Expand retirement savings by repealing 25% of compensation limit for defined contribution plans

F. Repeal multiple-use test for 401(k) plans (the defined contribution plan version of section 415(e))

G. Simplification of Section 404 (pension deduction rules)

1. Allow plans to use section 415 definition of compensation for deduction purposes
2. Exclude employee 401(k) contributions from 15% deduction limitation
3. Repeal combined plan deduction limitation

ACLI and other trade associations that support small business hope this Committee will consider these proposals this year.

Our private pension system offers the best hope of providing the retirees of America's small businesses with a secure and dignified retirement. A substantial number of workers not covered by a retirement plan work for small employers in the private sector. The ACLI applauds the fact that Congress and the Administration have embraced the concept of a simplified defined benefit approach for small business, and we will work with you to implement such a program.

I very much appreciate being given the opportunity to deliver the ACLI's views. I am happy to respond to any questions you may have.

Mr. PORTMAN. Thank you, Mr. Merolli.

Mr. Moore.

GREGORY MOORE, DEPUTY DIRECTOR, PENSION RIGHTS CENTER

Mr. MOORE. Thank you, Mr. Chairman. My name is Gregory Moore and I'm the deputy director of the Pension Right Center public interest group that works to protect and promote the pension interest of workers, retirees and their families. Thank you very much for inviting us to testify on the critical issue of pension coverage.

As Chairwoman Johnson noted in announcing this hearing, over 50 million U.S. workers have no pension coverage of any kind and most of these work for small employers. Based on these numbers, half of this country's workers will retire with Social Security benefits as their sole source of income. Given that the current average Social Security benefit is $8,900 annually—or $24.49 a day—it is clear that Social Security alone cannot provide retirees with a decent quality of life.

While distressing, the fact that working Americans have so little to rely on in their retirement years should come as no surprise. For much of the past decade, emphasis on retirement income has shifted from employer paid pension plans to employee funded savings plans. Yet all indications are that the typical worker in this country cannot put aside enough money to retire in a voluntary savings plan early enough in their career to accumulate the amounts necessary to provide an adequate supplement to Social Security.

A person earning the median $28,000 a year needs to set aside at least one-quarter of a million dollars for retirement. Yet most recent government statistics show that the typical household has only $15,000 in their 401(k)-type plans. The lack of sufficient savings for retirement is understandable—even predictable—given several trends in employee wages and benefits. Between January 1976—when many of ERISAs provisions became effective—and January 1998, wages for production workers in this country declined 28.3 percent when adjusted for inflation. The declining value of a paycheck, viewed in concert with dramatic increases and employee healthcare costs, goes a long way toward explaining why retirement savings are so low. Indeed, in light of these facts, it is almost unrealistic to expect American workers to choose to save.

Compounding the problem is the fact that small businesses face numerous obstacles to establishing and maintaining defined benefit plans. From the small business owners' perspective, significant startup costs, administrative expenses and demanding funding requirements can make traditional plans cost prohibitive. Lack of affordability and complex formulas limit the attractiveness of the defined benefit plans to even employees. Fortunately, several bills now before Congress seek to address the legitimate, financial concerns of small businesses and of the retirement needs of those workers.

One such bill is the SAFE bill. SAFE would provide small business owners with a simplified defined benefit option. SAFE plans will allow employers flexibility in deciding from year to year whether they can afford to contribute—a very attractive feature for small business owners. Employers would be permitted to give pension credit for years worked before the plan started and spread the cost of past service liability over as much as a decade. SAFE plans, unlike saving plans, assure that money will be set aside for individuals at all income levels. These plans would preserve retirement money for retirement. It would provide professionally pooled management. Most of these SAFE provisions are typical features of the traditional pension plans. At the same time, SAFE plans would also include the most attractive features of 401(k)s. All contributions would be 100 percent vested. They would offer rules that are simple; benefits that are portable; and formulas that are fair to lower paid and shorter service workers.

The Pension Right Center supports the major concepts incorporated in SAFE proposals. Yet, we believe that this legislation could be strengthened in a number of key aspects.

First, we urge you to adopt joint and survivor protection for the SAFE annuity. Second, to provide Pension Benefit Guaranty Corporation insurance to safeguard benefits. Third, limit preretirement cash outs that reduce retirement savings. To varying degrees, these provisions are included in the administration's SMART proposal. The Center also strongly supports the adoption of a modified version of SAFE, but we don't think it should be the exclusive proposal. We urge the Subcommittee to explore the pension bill of Senators Jeffords and Bingaman, Congresswoman Barbara Kennelly's legislation protecting women and the Pension Counseling Assisting Act introduced by Congressman Charles Schumer.

Thank you for the opportunity to testify. I'd be happy to answer any questions.

[The prepared statement follows:]

Statement of Gregory Moore, Deputy Director, Pension Rights Center

Good afternoon. My name is Gregory Moore. I am Deputy Director of the Pension Rights Center, a public interest group that has been working for more than two decades to protect and promote the pension interests of workers, retirees and their families. Thank you for inviting us to testify on the critical issue of pension coverage.

As Congresswoman Johnson noted in announcing this hearing, over 50 million U.S. workers have no pension coverage of any kind. Nearly two-thirds of those working for small employers (businesses with fewer than 200 employees) are without pension plans. Consequently, half of this country's workers will retire with Social Security benefits as their sole source of income. Given that the current average Social Security benefit is $8,940 annually – or $24.49 per day – it is clear that Social Security alone cannot, and was never intended to, provide retirees with a decent quality of life.

While distressing, the fact that working Americans have so little to rely on in their retirement years should come as no surprise. For much of the past decade emphasis on retirement income has shifted from employer-paid pension plans to employee funded savings plans. Indeed, employers no longer seek to attract workers by offering generous pension benefits, rather, workers are admonished to "choose to save."

Yet all indications are that the typical worker in this country cannot put aside enough money in a voluntary savings plan early enough in a career to accumulate the amounts necessary to provide an adequate supplement to Social Security. (Experts estimate — a person earning the median income of $28,320 a year needs to set aside at least a quarter of a million dollars, someone earning $50,000 will need $1 million). Yet the most recent government statistics (the 1995 Survey of Consumer Finance published by the Federal Reserve Board of Governors) show the typical household with only $15,600 in their 401(k) type accounts.

The lack of sufficient savings for retirement is understandable, even predictable, given several trends in employee wages and benefits. Between January 1976, when many of the Employee Retirement Income Security Act (ERISA) provisions became effective, and January 1998, wages for production workers in this country declined 28.3% when adjusted for inflation. The declining value of a paycheck, viewed in concert with dramatic increases in employee-paid health care costs goes a long way toward explaining why so little is saved for retirement.

Indeed, in light of these facts, it is unrealistic to expect working Americans to "choose to save."

Compounding the problem is the fact that small businesses face numerous obstacles to establishing and maintaining defined benefit plans. From the small business owners perspective, significant start-up costs, administrative expenses, and demanding funding requirements can make traditional plans cost prohibitive. Lack of portability and complex formulas limit the attractiveness of defined benefit plans to employees, making small business owners less likely to offer and maintain such plans.

Fortunately, bills now before Congress seek to address the legitimate financial concerns of small employers and the retirement needs of those working for small businesses.

One such bill is the Secure Assets For Employees (SAFE) proposal (HR 1656). SAFE would provide small business owners with a simplified defined benefit option. SAFE plans would allow employers flexibility in deciding from year to year whether they can afford to contribute — a very attractive feature for small business owners. Employers would be permitted to give pension credit for years worked before the plan started and to spread the cost of past service liability over as many as 10 years.

SAFE plans, unlike savings plans, would assure that money would be put aside for retirement for individuals at all income levels. These plans would preserve retirement money for retirement, and would provide for professional pooled management, rather than leaving it to individuals to make difficult investment decisions they may not feel comfortable, or interested, in making. Most of these SAFE provisions are typical features of traditional pension plans.

At the same time SAFE plans would also include the most attractive features of 401(k)s. All contributions would be 100 percent vested. They would offer rules that are simple, benefits that are portable, and formulas that are fair to lower-paid and shorter-service workers.

The Pension Rights Center supports the major concepts incorporated in the SAFE proposal, yet we believe that the legislation should be strengthened in a number key respects. For example, we urge you to add joint and survivor protections for the SAFE Annuity, and Pension Benefit Guaranty Corporation insurance to safeguard benefits. To deter pre-retirement cash outs it would also be helpful to restrict rollovers of contributions to other retirement plans or special IRA's that lock benefits in until retirement age. To varying degrees, these three provisions are included in the Administration's SMART proposal.

Equally important, to ensure SAFE's ability to protect workers, consideration should be given to making sure that adoption of SAFE plans does not jeopardize the employment of older workers. Because SAFE plans are heavily weighted in favor of older employees, it will be particularly costly to provide pensions to older workers, and therefore tempting to fire or not to hire these employees.

There are different ways that protection against this kind ofage discrimination can be assured. One would be to have the Labor Department investigate and enforce claims by individuals that they were fired (or not hired) because of the costs of providing them benefits under a SAFE plan. A second, would be to create a rebuttable presumption that people fired (or not hired) within a year of the adoption of a SAFE plan were discriminated against for pension reasons under Section 510 of (ERISA).

The Pension Rights Center strongly supports adoption of a modified version of SAFE, though we do not think it should be the exclusive new option for employers interested in a simple and fair method of providing pension security for their workers. We urge this Subcommittee to also explore approaches that would enable employers to attract younger workers by providing them with more adequate benefits for employment early in their careers. This concern is specifically addressed by legislation that has been introduced into the Senate by Senators Jeff Bingaman and James Jeffords called the Pension ProSave Act of 1997. Although there are important respects in which we would like to see this proposal modified, it has some very appealing features to recommend it. Like SAFE it incorporates what we consider to be the best of traditional plans and the best of 401(k)s.

In addition, to enacting legislation to encourage more employers to have pensions, there is also need to provide protections for people already in plans. In this connection, we strongly recommend adoption of Congresswoman Barbara Kennelly's legislation, the Comprehensive Women's Pension Protection Act of 1997 and the Pension Counseling and Assistance Act of 1997 introduced by Congressman Charles Schumer (H.R. 2167).

Thank you for this opportunity to testify. I would be happy to answer any questions you may have.

Mr. PORTMAN. Thank you, Mr. Moore.
Mr. Leonard.

STATEMENT OF JAMES V. LEONARD, VICE CHAIRMAN, ENGINEERING EMPLOYMENT BENEFITS COMMITTEE, INSTITUTE OF ELECTRICAL AND ELECTRONICS ENGINEERS, INC.–UNITED STATES OF AMERICA

Mr. LEONARD. Good afternoon, Members of the Oversight Subcommittee. I'm James V. Leonard from St. Charles, Missouri, and I'm testifying here today as vice chair of the Engineering Employment Benefits Committee of the Institute of Electrical and Electronics Engineers/USA, IEEE–USA. I want to thank the Chair and Members of the Subcommittee for holding public hearings on these critically important issues.

The IEEE is a transnational, technical, professional society whose membership currently includes more than 320,000 electrical, electronics and computer engineers throughout the world. Of those, 219,000 reside in the United States. Of IEEE's employed U.S. members, nearly 70 percent work for private businesses. Of those in the private sector, 80 percent are employed by midsize and large companies and 20 percent by small businesses—and that's up from 10 percent in 1989.

We have been looking into and working with legislative efforts in the pension area since the enactment of ERISA in 1974. Over the years, IEEE–USA has worked in concert with 17 other engineering organizations under the auspices of the American Association of Engineering Societies in support of major pension reform and retirement savings proposals. We have spearheaded efforts to organize a broad-based pension portability coalition to educate the members of participating organizations, Congress and the public about needed and proposed improvements and affordability of pension benefits. These problems must be fixed before the baby boom generation begins to retire early in the next century. Legislation has been introduced in both Houses of Congress that we think will help expand pension coverage in the rapidly growing small business sector and at the same time offer promising solutions to the vesting, affordability, retirement preservation, minimum benefit standards and administrative complexity problems that IEEE members are concerned about.

The SAFE Act. The purpose of the SAFE plan act, as introduced last year by Representatives Nancy Johnson, Earl Pomeroy, and Harris Falwell is to encourage small businesses who establish simple secure pension plans for their employees. SAFE incorporates some of the best features from defined contribution pension plans like the highly respected TIAA–CREF and for more traditional defined benefit plans. the result is a prototype defined benefit plan that, unlike most others, is fully portable.

The SAFE proposal facilitates pension portability. SAFE protects the real value—that is the purchasing power of earned benefits. SAFE also insures preserved preservation of benefits for use in retirement. In addition, the SAFE proposal includes provisions permitting the accumulation of up to 10 years of past service credits and simplified reporting and administrative requirements that should make it a particularly attractive benefit option for small business.

The President's Plan. As part of the fiscal year 1999 budget, the Clinton administration has proposed some pension reforms of its own. The President's 1998 pension package also includes a new a prototype defined benefit plan for small employers. With a few important exceptions, the President's new secure money, annuity or retirement trust—or SMART plan—bears a striking resemblance to the SAFE plan. Like SAFE, the SMART plan will permit small businesses to set up new, simplified tax-favored retirement account that combines the best features of defined benefits and defined contributions plans. In addition, the minimum benefit under SMART trust option would be guaranteed by the PBGC. The PBGC insurance feature should help to enhance the attractiveness of SMART to some employers provided the required premiums are set and kept at the low amount specified earlier of $5.00.

A major concern of IEEE–USA and for many other organizations representing individuals who are maybe or work for professional service providers are those provisions that could specifically exclude employers from eligibility to participate in a SMART plan. To us it makes no sense for the administration to propose a pension coverage expansion proposal that will deprive a growing part of the small business community of an opportunity to participate in such an important retirement savings plan.

And I will say in conclusion, the IEEE–USA urges the Oversight Subcommittee to favorably support the SAFE Act and report it to the Full Committee on Ways and Means and to recommend that the bill in its present or amended form move forward expeditiously for a vote in the House and Senate. I also request that the attached comments and recommendations on SAFE prepared by Thomas C. Woodruff, a resident of Norwalk, Connecticut be included in the records for these hearings.

Thank you for your attention and I'll be pleased to answer any questions later on.

[The prepared statement and attachments follow:]

Statement of James V. Leonard, Vice Chairman, Engineering Employment Benefits Committee, Institute of Electrical and Electronics Engineers, Inc.–United States of America

1. Introduction

Good Afternoon, Madam Chairman and members of the Oversight Subcommittee. I am James V. Leonard from St. Charles, MO. I am testifying here today as the Vice Chairman of the Engineering Employment Benefits Committee of the Institute of Electrical and Electronics Engineers—United States of America (IEEE–USA), one of the world's largest professional societies. I hold bachelor's, masters and honorary professional degrees in electrical engineering from the University of Akron, Washington University of St. Louis and the University of Missouri at Rolla and have worked as an engineer for a major aerospace and defense company for 35 years.

The views expressed in my testimony are those of IEEE–USA and are not those of my employer.

On behalf of the professional society that I represent, I want to thank the Chair and the members of the Subcommittee for holding public hearings on such critically important issues as the current availability of pensions to American workers, incentives for and obstacles to expansion of the nation's voluntary private pension system, especially among small businesses, and the financial status of defined benefit plans monitored by the Pension Benefit Guaranty Corporation (PBGC).

2. IEEE–USA's Interest in Pension Benefits Expansion and Simplification Issues

The Institute of Electrical and Electronics Engineers is a transnational technical and professional society whose membership currently includes more than 320,000 electrical, electronics and computer engineers in 147 countries throughout the world. IEEE–USA promotes the technology policy and professional careers interests of the 219,000 IEEE members who live and work in the United States.

Of IEEE's employed U.S. members, nearly 70 percent work for private businesses; 10 percent work for Federal, state or local government agencies; 10 percent are deans, professors or instructors at post-secondary educational institutions or work for non-profit research centers. The remainder are self-employed and provide consulting services to businesses and government.

Of those in the private sector, 80 percent are employed by mid-sized and large companies.Twenty percent work for small businesses, up from less than 10 percent in 1989.

Although most of our members work for employers that offer tax-qualified pension plans and other retirement savings programs, long-standing concerns about problems that limit the effectiveness of the nation's voluntary private pension system and the extent to which it discriminates against mobile workers have prompted IEEE–USA to take an active part in legislative efforts to improve the system since the enactment of ERISA in 1974.

Over the years IEEE–USA has worked in concert with 17 other engineering organizations under the auspices of the American Association of Engineering Societies in support of major pension reform and retirement saving proposals. More recently, we have spearheaded efforts to organize a broad-based pension portability coalition to educate the members of participating organizations, Congress and the public about needed and proposed improvements in the portability of pension benefits for mid-career workers. A copy of the Coalition's vision, mission and goals is included as an attachment to our statement.

Pension problems that remain unresolved include: limited coverage, particularly among small businesses; eligibility and vesting standards that penalize mobile workers; impediments to the portability of benefits, especially from defined benefit plans; the propensity of plan participants to spend rather than save pre-retirement distributions; the absence of minimum contribution requirements needed to ensure that retirees receive adequate benefits; and complex rules and regulations that make it too costly for many employers—especially small employers—to establish and administer pension plans for their employees.

Because employer-sponsored pensions are such an important supplement to Social Security benefits and personal savings—especially for lower and middle income Americans—these problems must be fixed before the baby-boom generation begins to retire early in the next century. And to the extent that employer-sponsored pensions are such an important source of the savings needed for productive investment in the nation's economy, expanded coverage will also help to improve America's technological competitiveness and its living standards.

Fortunately, legislation has been introduced in both houses of Congress that we think will help to expand pension coverage in the rapidly growing, small business sector and, at the same time, offer promising solutions to the vesting, portability, retirement asset preservation, minimum benefits standards and administrative complexity problems that IEEE–USA members are concerned about.

Among the most innovative of these legislative proposals is the SAFE Plan Act.

3. The Secure Assets for Employees (SAFE) Plan Act (H.R. 1656)

The purpose of the SAFE Plan Act—as introduced last year by Representatives Nancy Johnson (R–CT), Earl Pomeroy (D–ND) and Harris Fawell (R–IL) and included in two important pension reform proposals in the Senate (the Retirement Income and Savings Act—S. 883 and the Retirement Security for the 21st Century Act—S. 889)—is to encourage small businesses to establish simple, secure pension plans for their employees.

SAFE incorporates some of the best features from defined contribution pension plans like the highly respected TIAA–CREF and from more traditional defined benefit plans. The result is *a prototype defined benefit plan* that, unlike most others, *is fully portable*. Here's how it works:

A qualifying employer (with up to 100 employees) can establish a plan *in the form of an annuity or as a trust*. All employees who received at least $5,000 in compensation from the employer during any two, consecutive preceding years and at least $5,000 in the current year are eligible to participate. The employer can contribute an amount equal to 1%, 2% or 3% of each eligible employee's annual compensation to the annuity or the trust. And once these contributions have been made, *each employee's benefit is fully and immediately vested*.

The SAFE proposal *facilitates pension portability* (benefit transferability) by permitting terminating plan participants to: 1) use the assets held in a SAFE trust to purchase a SAFE annuity that will pay the promised benefit at retirement; 2) to make a direct trustee to trustee transfer to a subsequent employer's plan; or to transfer the present value of their SAFE assets into a rollover IRA.

SAFE *protects the real value* (purchasing power) of earned benefits by funding employer and employee contributions based on present year salaries and by providing an opportunity for an enhanced benefit if the SAFE annuity or trust earns more than 5% in any given year.

SAFE also ensures *preservation of benefits* for use in retirement by providing for a direct transfer of SAFE assets to an annuity or to a rollover IRA should participants change or lose their jobs.

In addition, the SAFE proposal includes provisions permitting the accumulation of up to ten years of *past service credits* and *simplified reporting and administrative requirements* that should make it a particularly attractive benefit option for small businesses.

4. President Clinton's Small Business Pension Proposal

As part of the Fiscal Year 1999 Budget, the Clinton Administration has proposed some pension reforms of its own. In addition to a modest start-up tax credit designed to expand coverage by encouraging small businesses to establish some form of pension plan (a Simple IRA, Simple 401(k) or Simplified Employee Pension) for their employees and a new salary-reduction IRA, the President's "1998 Pension Package" also includes a new protype defined benefit plan for small employers. With a few important exceptions, the President's new Secure Money Annuity or Retirement Trust (SMART) plan bears a striking resemblance to the SAFE Plan.

Like SAFE, the SMART plan will permit small businesses (with up to 100 employees) to set up a new, simplified tax-favored retirement account that combines the best features of defined benefit and defined contribution plans. As its title suggests, the President's Plan also offers annuity and trust options. SMART also allows employer contributions ranging from 1% to 3% of each employee's compensation; provides for full and immediate vesting of benefits; guarantees a fully funded minimum defined benefit with the possibility of a greater benefit if investment returns exceed 5%; facilitates portability and retirement asset preservation through the purchase of annuities or direct transfers to an IRA or another employer's plan; and simplifies plan administration and reporting requirements.

In addition, the minimum benefit under the SMART trust option would be guaranteed by the Pension Benefit Guaranty Corporation, subject to payment by plan sponsors of a reduced premium. This PBGC insurance feature should help to enhance the attractiveness of SMART to some employers, provided the required premiums are set and kept at low single digit levels.

Unlike SAFE, however, the President's proposal does *not* provide for past service credits.This omission is likely to make SMART less attractive than SAFE to many small business owners.

A major concern for IEEE–USA and for many other organizations representing individuals who may be, or work for, professional service providers are those provisions that would specifically exclude such employers from eligibility to participate in a SMART plan. In dynamic and rapidly changing American labor markets, especially in the high technology sector, more and more professionals—including engineers—are establishing small businesses or providing professional services as the employees of small businesses. To us, it makes no sense for the Administration to propose a pension coverage expansion proposal that will deprive a growing part of the small business community of an opportunity to participate in such an important retirement savings plan.

In our opinion, the proper way to address concerns about revenue losses and/or potential abuses by some highly compensated individuals, is to establish a cap on the compensation that is taken into account for benefits purposes—not by excluding certain classes or groups of workers based solely on the way they are organized or the nature of the services they provide.

In this regard, the SAFE proposal limits the maximum compensation to be taken into account in determinining tax-favored benefits at $165,000. The SMART plan sets a limit of $100,000.

Even though very few of our members would be adversely affected by the lower compensation limit, we are concerned that a $100,000 unindexed cap may be a deterrent to participation by many small business owners, thereby unnecessarily limiting the effectiveness of SMART as an incentive for expanding pension coverage for their employees.

In conclusion, IEEE–USA urges the Oversight Subcommitte to favorably report the Secure Assets for Employees (SAFE) Plan Act to the full Committee on Ways and Means and to recommend that the bill, in its present (or an amended form including appropriate spousal protections), be moved forward expeditiously for a vote in the House and the Senate.

I have also requested that the attached comments and recommendations on SAFE—prepared by Thomas C. Woodruff, a nationally recognized expert on pensions and retirement savings issues—be included in the record of these hearings.

IEEE–USA and other organizations in the American Association of Engineering Societies and the Pension Portability Coalition will do our part to enlist additional cosponsors and build the grass roots support that will be needed to enact this important legislation in the 105th Congress.

Thank you for your attention. I'll be pleased to try to answer any questions that you may have.

Pension Portability Coalition—"You Can Take It With You"

VISION STATEMENT

The Pension Portability Coalition envisions that by the Year 2000, portability will be a reality.

Pension portability means:

- Pension Benefit Transferability

The ability to transfer pension assets or service credits from one plan to another

- Benefit Value Protection
- To minimize the impact of inflation on the purchasing power of pension benefits
- Retirement Asset Preservation

To encourage individuals to save rather than spend preretirement pension distributions

MISSION STATEMENT

In order to increase the productivity and retirement income security of American workers, the mission of the Pension Portability Coalition is to *Support Enactment of Pension Portability Improvement Legislation*

GOALS

To educate the members of participating organizations about needed and proposed improvements in pension portability,

To identify and evaluate pension portability improvement options, including legislative and non-legislative alternatives, and

To inform concerned organizations, through Congressional, industry and public relations, of its evaluations in order to influence and provide a focus for improvements in pension portability.

Remarks on Oversight of Pensions Including Plan Availability, Coverage Expansion and Related Issues

BY THOMAS C. WOODRUFF, PH.D.

INTRODUCTORY REMARKS

My name is Thomas Woodruff. For the past twenty-four years, I have worked in the private sector, the federal government, and academia on personal finance and retirement planning issues. From 1978 to 1981, I was the Executive Director of the President's Commission on Pension Policy. That Commission found serious gaps in pension plan participation in the U.S. workforce, particularly those working for small businesses, and called for sweeping changes in our public policy toward our public and private pension systems. After working as a Visiting Professor at Cornell University, I directed a foundation-sponsored blue-ribbon panel called the Commission on College Retirement. The Commission on College Retirement's work lead to an overhaul of TIAA–CREF, the nation's largest network of portable pension plans. In my current capacity as a small business owner, I write extensively about personal finance and retirement planning issues, and provide consulting services to financial services companies and membership organizations such as the Institute of Electrical and Electronic Engineers—United States of America (IEEE–USA).

PENSION PLAN PARTICIPATION IN SMALL BUSINESSES

First, I would like to say that I concur completely with the testimony delivered today by the IEEE–USA. I will not repeat the points made in that testimony. I would like to say that the SAFE Plan Act's sponsors, Representatives Nancy Johnson, from my state of Connecticut, Earl Pomeroy , and Harris Fawell are to be commended for introducing this thoughtful and important piece of legislation.

I have just two points to make regarding public policy toward small business pension plans and the SAFE Plan Act. First, I believe that continuation of current policy will lead to the ongoing disenfranchisement of small business employees from both the tax benefits and retirement income security that they derive from private pension plans. And, second, I believe that a minor improvement to the SAFE Plan

Act could have a major positive impact on the retirement income security of those who would participate in SAFE plans in the future.

FEDERAL POLICY TOWARD SMALL BUSINESS PENSION PLANS CONTINUES TO BE A FAILURE

In its final report to Congress and the President in 1981, the President's Commission on Pension Policy concluded: " The most serious problem facing our retirement system today is the lack of pension coverage among private sector workers." The Commission also said that the "lack of pension plan offerings in small businesses is a major reason why pension plan growth is expected to continue to stagnate."

Among other reasons, the Commission cited the administrative expenses of actuarial, accounting, insurance and investment services necessary to operate small plans, particularly defined benefit pension plans as a problem that needed to be solved. In addition, the Commission found that eligibility and vesting requirements in traditional defined benefit plans are just not well suited for small businesses due to employee turnover as well as the uncertain life expectancy of many of these enterprises.

Unfortunately, in the seventeen years since the President's Commission on Pension Policy issued its report, the low level of pension plan participation among employees of small businesses has remained virtually stagnant.

The SAFE Plan Act goes a long way toward addressing the administrative and plan design problems faced by small business pension plans. While I would not expect that passage of the SAFE Plan Act would lead to pension plan coverage among small businesses to approach the levels found in large businesses today, enactment of the SAFE Plan Act would help remove a few unnecessary barriers to pension plan formation and maintenance.

THE SAFE PLAN ACT COULD BE IMPROVED

Among the most important problems that we face in designing pension plans is how to retain the purchasing power of pension benefits as they are earned during the working years and when they are received during retirement.

In its Trust form, the SAFE Plan Act does provide that employees would benefit from earnings in the Trust above the assumed interest rate used for funding the Trust. This would provide the opportunity for them to begin retirement with either an annuity or an income stream with purchasing power sufficient to maintain their standard of living. However, no provision is made for similar participation in earnings or dividends with the SAFE Annuity form. In addition, the Act seems to presume that the annuities that would be purchased by the plan or by individuals at retirement would be fixed annuities.

One of the lessons that I learned when I was President of the Commission on College Retirement was the importance of the "participating" and "variable" forms of annuities. The TIAA–CREF pension plans have historically been funded with participating and variable annuities both as accumulating and pay-out annuities.

TIAA is essentially a large portfolio of fixed-income investments that promises to its participant/investors a guarantee of principal plus a minimum rate of return. Any earnings above the minimum guarantee are paid to participant/investors as dividends. This is true both while the participants are working and when they choose to annuitize the accumulated funds.

CREF was established in 1952 as a variable annuity with a diversified portfolio of stocks as its underlying investment. Since 1989, CREF has diversified to include a money market fund, and a variety of stock and bond portfolios. Unlike TIAA, CREF does not guarantee a minimum rate of return. During the accumulation period, however, participants do receive the full benefit of the earnings in the underlying assets, much like participants in 401(k) plans. At retirement, participants also have the option of converting their CREF accumulations into a variable pay-out annuity. Initial payments begin using a 4% assumed interest rate and adjustments are made periodically, up or down, based on whether the investment returns reach or exceed the 4% target.

TIAA and CREF annuities have served higher education and the non-profit community very well. The TIAA–CREF approach toward participating and variable annuities provides one example of how these annuity forms can help preserve the purchasing power of retirement benefits for workers. A modification of the SAFE Plan Act to include participating and variable annuities both in the SAFE Annuity form for active employees and for deferred and pay-out annuities for terminated employees and retirees would greatly enhance the benefits that could be paid by these plans without increasing their cost to employers.

Mrs. JOHNSON of Connecticut. Thank you.
Ms. Shaffer.

STATEMENT OF GAIL S. SHAFFER, EXECUTIVE DIRECTOR, BUSINESS AND PROFESSIONAL WOMEN/USA

Ms. SHAFFER. Thank you, Madam Chair and distinguished Members of the Subcommittee. We very much appreciate your allowing us this opportunity to testify today.

I'm Gail Shaffer, executive director of Business and Professional Women/USA, BPW/USA. We're an organization representing 70,000 working women across the country. A third of our members are businessowners. Our members are involved in more than 2,000 local chapters nationwide—at least one in almost every congressional district in the nation.

We applaud your Subcommittee for focusing on the status of our Nation's pension system and allowing us to bring to your attention the particular ways in which the system's current inadequacies disproportionately affect women in an adverse way. For working women retiring, they come against a reality that might be characterized as the "showdown at gender gap." There is already a 26-cent gender gap in the average American wage scale and that is compounded in retirement and translates into a 50 percent retirement gap. Obviously, this raises major equity issues and BPW has had a longstanding interest in this issue. We have been working not only to effect change on Capitol Hill, but also to educate our members on the importance of retirement planning.

I'm very glad that Congressman Portman cited the publication in Good Housekeeping magazine which hits the stand today. We will be helping to distribute that, but it was really a project sponsored by the Teresa and John Heinz III Foundation and the Women's Institute for a Secure Retirement—also known as WISER—which has been a partner to BPW as we work on these issues.

BPW was also a lead organization behind the passage in 1984 of the Retirement Equity Act which was a critical first step in addressing some of the difficulties women have faced in gaining greater access to pension benefits, particularly as spouses and widows. Since that Act was passed, there has been modest improvement in the rate of pension coverage for women which is certainly a welcome development. However, that progress has been undermined by ongoing structural barriers and also by the overall shift away from defined benefit or basic pension plans to do-it-yourself defined contribution plans. This plan will leave women more financially vulnerable at retirement.

Several factors contribute to the fact that women are especially vulnerable to economic insecurity in old age. The first is lifespan. Although longevity is certainly generally considered to be a blessing, when it comes to retirement security the fact that women live longer on the average than men becomes a disadvantage. Unless women begin retirement with a bigger nest egg and a larger pension—which is rarely the case, the march of time and the pressures of inflation will combine to make their later years—at best—uncomfortable and at worst—poverty stricken. Financial experts tell

Americans to plan to replace 70 to 80 percent of their income at retirement. Unfortunately, that advice does not work for women who are likely to need more than 100 percent of their preretirement income in order to maintain that security through a longer lifespan.

Second, marital status is an important factor. Being single in old age is somewhat financially risky, but for women it is much more so. Consider that in 1992 only 6 percent of married women over age 65 fell below the poverty line; but well over 20 percent of single women fit the government's definition of poverty. About 21 percent of women who were either widowed or never married were poor; while the percentage of divorced women in poverty climbed to 29 percent. It is important to keep in mind that as these women grow older—as they reach, say 75 or 85—that poverty rate climbs, as well.

Living alone is another factor. Three-quarters of men, age 65 and older, live with a spouse; while only one-third of women do. A single elderly woman is twice as likely as an elderly man to be poor. Furthermore, the Nation's pension system is reflecting a work pattern that does not reflect the reality of women's working lives. Women over 25 tend to stay in jobs a shorter period of time and leave the work force for care giving responsibilities, for example. Women also are much less likely to have a pension and when they do, they are concentrated more in low-wage service part-time jobs and also more likely to work for a smaller business. So a majority still are not covered by any pension at all.

The type of pension offered also makes a big difference. We recognize it is challenging to create the kind of ideal system we are all looking for. But we are very concerned about the marked shift from defined benefit plans toward defined contribution plans because it disproportionately hurts women. As I mentioned, women earn on average less than three-quarters of what men earn. The gender gap in wages means they have substantially less income available to put in an IRA or 401(k) plan. Three out of four working women earn less than $23,000 annually. Only 10 percent of them earn over $45,000 annually.

Second, studies have shown that women's savings priorities are focused on their children's education, rather than retirement.

Third, they move in and out of the work force and from one job to another more frequently and the lack of pension portability is a very significant problem for them. And again, because their priorities focus on things such as education and medical emergencies, they are much more likely to cash out their accumulations, rather than keep those funds in the retirement account.

And finally, given the fact that women generally have smaller amounts in their 401(k) account, they tend to be much more risk averse in their investment approach. Consider that over age 40, the average woman has accumulated only $7,000 in her 401(k), whereas the average man has accumulated $20,000 in his. That makes the investment choices different and certainly the wage gap and other factors have contributed to a less desirable set of options.

For all of these reasons, a defined contribution plan may not always be the best option for women who might, in fact, be better served by the features in the defined benefit plan that guarantees a certain minimum benefit; that does not place all the burden on the employee; and is guaranteed to be paid out in monthly installments over the remainder of one's life.

To be fair, defined benefit plans do not solve all of the problems that women face in retirement planning—the wage gap, the career interruption, stringent investment requirements still tend to depress the size of those pensions for women as compared to men. And over the long term, inflation will certainly erode the value of the benefit. But the annuitized format of these plans and their reliability and the participation of employers are features that are certainly important to women as current and future retirees.

Unfortunately, as everyone knows, small businesses particularly, need plans that have a minimum of complexity and are affordable. And as I said, one-third of our members are small business owners and this is something we are very concerned with. That's why we are so pleased that Congresswoman Johnson, you and your colleague, Congressman Pomeroy and others have introduced H.R. 1656, the SAFE plan, to offer real pensions to workers that will guarantee a minimum defined benefit and introduce portability and other features that will be helpful. There are also important safeguards that we applaud in the bill that we feel will benefit both the small business owner and the retiree.

Businesses feel that it's truly helpful to small business owners when they are spared much of the administrative burden and complexity associated with more traditional qualified retirement plans. It is also designed, as others have said, to complement the SIMPLE plan, which many small businesses have begun to offer. We are very pleased there is bipartisan support for this plan. Our membership organization is a nonpartisan organization and we feel that it is truly a very fine answer to a complicated problem.

We would also like to mention our support for another bill that addresses problems for women achieving retirement equity—and that is the Comprehensive Women's Pension Protection Act—H.R. 766 and S. 320—which Congresswoman Kennelly has supported along with Senator Carol Moseley-Braun. This is also important, to address systemic barriers for women because it addresses specific gender inequities within current law. For example, it provides for automatic division of pension benefits in a divorce and also improves spousal consent provisions for 401(k)s.

We would be glad to comment further as the bills evolves in the Congress. We very much appreciate this opportunity today and particularly the focus that this Subcommittee has put on a very important issue to small business owners and to women facing retirement.

[The prepared statement follows:]

Statement of Gail S. Shaffer, Executive Director, Business and Professional Women/USA

Good afternoon. I want to thank the members of the Subcommittee and particularly Congresswoman Johnson for inviting me today. I am Gail Shaffer, Executive Director of Business and Professional Women/USA, an organization representing 70,000 working women across the country, a third of whom are business owners. Our members are involved in more than 2,000 local chapters nationwide—at least one in nearly every congressional district in the nation.

We applaud this committee for focusing on the status of our nation's pension system, and for allowing us to bring to your attention the ways in which the system's current inadequacies disproportionately affect women. BPW has had a long-standing interest in this issue, and we are working not only to effect change on Capitol Hill, but also to educate our own members on the importance of retirement planning. In this regard, it just so happens that the April issue of Good Housekeeping Magazine, which hits the stands today, includes a guide for women on retirement planning sponsored by the Theresa and H. John Heinz, III Foundation and the Women's Institute for a Secure Retirement—also known as WISER. BPW is working in partnership with WISER and will be helping to disseminate thousands of these guides across the country.

BPW was also a lead organization behind the passage of the Retirement Equity Act of 1984, which was a critical first step in addressing some of the difficulties women faced in gaining greater access to pension benefits, particularly as spouses and widows.

Since the REA was passed, there has been some modest improvement in the rate of pension coverage for women, which is certainly a welcome development. However, that progress has been undermined by ongoing structural barriers and by the overall shift away from defined benefit, or "basic pension" plans to do-it-yourself, defined contribution plans. This trend will leave women more financially vulnerable at retirement.

Several factors contribute to the fact that women are especially vulnerable to economic insecurity in old age. The first is lifespan. Although longevity is generally considered to be a blessing, when it comes to retirement security, the fact that women live longer than men is a disadvantage. Unless women begin retirement with a bigger nest egg and a larger pension—which is rarely the case—the march of time and the pressures of inflation will combine to make their later years at best uncomfortable and at worst poverty-stricken. Financial experts tell Americans generally to plan to replace 70 or 80 percent of their income at retirement. Unfortunately, this advice doesn't work for women, who are likely to need more than 100 percent of their pre-retirement income in order to remain secure throughout their longer lives.

Marital status is another important factor. Being single in old age is somewhat financially risky, but for women it is substantially more so. Consider that in 1992, only six percent of married women over age 65 fell below the poverty line. But well over 20 percent of single women fit the government's definition of poverty. About 21 percent of women who were either widowed or never married were poor, while the percentage of divorced women in poverty climbs to 29 percent. And it is important to keep in mind that as women grow older, as they reach 75 or 85 or older, their poverty rate also climbs.

Living alone is another predictor of elderly poverty and women are much more likely than men to live alone. Three-quarters of men age 65 and older live with their spouse but only one-third of women do. A single elderly woman is twice as likely as an elderly man to be poor. It is also important to note that our nation's poverty rate for single elderly women, which stands at about 18 percent, is by far the highest percentage in the industrialized world. And the breakdown of poverty rates among minority groups is even more stark.

Although the nation's pension system is gender-neutral, it was set up to reward a work pattern that does not reflect the reality of women's working lives. For example, women over 25 tend to stay in jobs an average of only 4.7 years, whereas pension vesting rules generally require five years on the job. Women are much more likely to leave the workforce and three times as likely to work part-time to accommodate care-giving responsibilities. Women also earn less than men—an average of 26 percent less. The result of lower earnings means that women's pension benefits will be lower than those of men.

But most women aren't lucky enough even to have a pension, regardless of its size. Women are more likely to be working in low-wage, service, part-time jobs and/or to work for small businesses—where pension coverage is the most sparse. Although about 48 percent of full-time female workers have some form of pension coverage, a majority still do not. And only 39 percent of all female workers are covered.

The type of pension plan that is offered also makes a big difference. We recognize that it is challenging to create a system that covers as many workers as possible, and that access to defined contribution plans is certainly better than no retirement savings vehicle at all. But we are very concerned about the marked shift among employers away from defined benefit plans toward defined contribution plans. This trend disproportionately hurts women, for a few reasons.

First, women earn, on average, less than three-quarters of what men earn, and so they have substantially less income available to put in an IRA or a 401(k) plan. Three out of four working women earn less than $23,000 annually. Even a disciplined saver will have trouble accumulating much in savings at that level. Second, studies have shown that women's savings priorities are often focused on their children's education and not on retirement. Third, with women moving in and out of the workforce and from one job to another more frequently than their male counterparts, the problems associated with lack of portability become particularly acute for them. And again, because of priorities such as their children's education and medical emergencies, women often opt to cash out their 401(k) accumulations when they leave a job rather than keep the funds for retirement.

Finally, given the fact that women generally have smaller amounts saved in their 401(k) accounts and have less to fall back on from other sources, it is not surprising that they are often more averse to riskier, albeit higher yield, investments. It is not simply a lack of financial sophistication, it is actually a pretty rational behavior. Consider that over age 40, the average woman has accumulated only $7,000 in her 401(k) whereas the average man has accumulated $20,000 in his. This is already an exponential disparity which is further amplified as the effects of the wage gap, compound interest and investment choices take their toll over time.

It must also be said that even in best-case scenarios, where women have saved much, invested well, and have a sizable lump sum distribution available to them when they retire, it is still incumbent on them to manage these assets so that they will provide income for the remainder of their lives. If the market hits a prolonged slump, if they make poor investment decisions or fall prey to unscrupulous financial advisors, they could easily exhaust their assets late in life. And once the money is gone, it is gone.

For all of the reasons outlined above, defined contribution plans may not always be the best option for women, who might in fact be better served by the features available in a defined benefit plan—what we think of when we think of a traditional pension.

A defined benefit plan has a lot going for it as far as women are concerned. First, it does not place all of the burden on the employee to plan and execute her retirement savings all by herself. It features a contribution by the employer. It is less voluntary in nature and is a form of forced savings. It is also guaranteed to be paid out in monthly installments over the remainder of one's life, thus recipients are much less prone to the potential catastrophes of poor asset management.

To be fair, defined benefit plans do not solve all of the problems women face in retirement planning. The wage gap, career interruptions and stringent vesting requirements still tend to depress the size of women's pensions as compared to men. And over the long term, inflation will gradually erode the value of the monthly benefit. But the annuitized format of these plans, their reliability, and the participation of employers are all features that are particularly important to women both as current and future retirees.

Unfortunately, as everyone in this room knows, the cost and complexity of defined benefit plans has made them a difficult option for small businesses to pursue. The statistics bear this out: only about 24 percent of firms with fewer than 100 employees, and 13 percent of firms with 10 or fewer employees, offer such plans. Given that small businesses are creating the majority of the jobs in this country, it is clear that we ought to make it easier for these firms to offer defined benefit plans.

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

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

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

We are optimistic about the prospects of passing the SAFE bill in the foreseeable future, because it enjoys bi-partisan support, and because the Clinton Administration has also indicated its support for this concept. We would like both Congress and the Administration to know that BPW/USA supports this legislation and would very much like to see it signed into law this year.

We would also like to mention our support for another bill that addresses the problems women face in achieving retirement equity, and that is the Comprehensive Women's Pension Protection Act—H.R. 766 and S. 320. This bill was introduced in the Senate by Senator Carol Moseley-Braun and in the House by your colleague from Connecticut, Barbara Kennelly. The Senate version, S.320, has bi-partisan support, as Senator Olympia Snowe, with whom we have worked closely over the years, is a lead co-sponsor of the measure.

The Comprehensive Women's Pension Protection Act is important because in addition to attempting to address systemic barriers for women, it also addresses specific gender inequities within current law. For example, it provides for the automatic division of pension benefits in a divorce unless otherwise specifically provided in the settlement. Current law allows for division of pension benefits, but the process is confusing and many women are not made aware of these rights until after a divorce is final, when it is too late. The bill also improves spousal consent protections for 401(k)'s so that they are on a par with those pertaining to defined benefit plans when it comes to lump sum distributions. It expands options for joint and survivor annuity benefits so that either surviving spouse will have a benefit equal to two-thirds of the benefit received while both were living, and requires that *both* spouses be fully informed of their options before a decision is made. Currently, survivor benefits are half of the previous benefits, which can be a significant financial burden for women, who are more likely to be the survivor and less likely to have other sources of income.

I hope the members of this subcommittee will take a look at this legislation and consider lending their support to it as well. We believe that for anyone who is truly interested in improving gender equity and the economic status of older women, many of the provisions contained in this bill are must-see language.

In closing, I would like to once again commend this Subcommittee for focusing attention on this critically important issue. The implications of inadequate pension coverage are far-reaching—indeed, inter-generational. If we address this issue now and take steps that will narrow the gap between those retirees who are financially and those who are poor, we will not only be making an investment in our citizens, but also ensure a much smaller tax burden in the future.

Thank you for your kind attention to my remarks. I'd be pleased to take any questions you may have.

Mrs. JOHNSON of Connecticut. Thank you very much, Ms. Shaffer.

Mr. Callahan, it's a pleasure to welcome you back to the Subcommittee from Cheshire, Connecticut but also someone who was very instrumental in helping this Subcommittee write the SIMPLE legislation about a year ago. Welcome.

STATEMENT OF MICHAEL CALLAHAN, PRESIDENT, PENTEC, INC., CHESHIRE, CONNECTICUT; ON BEHALF OF AMERICAN SOCIETY OF PENSION ACTUARIES

Mr. CALLAHAN. Thank you. Good afternoon, Madam Chairwoman, and thank you for inviting the American Society of Pension Actuaries, ASPA, to testify before your Subcommittee on this important subject.

My name is Michael Callahan and I'm an enrolled actuary and president of PenTec, Inc.—a pension and actuarial consulting firm located in Cheshire, Connecticut.

PenTec provides services to retirement plans for over 500 Connecticut-based companies. I'm also a past-president of the American Society of Pension Actuaries on whose behalf I am testifying today.

ASPA is an organization of over 3,000 professionals who provide actuarial consulting services to approximately one-third of the retirement plans in the United States. The vast majority of these plans are for small businesses.

Ten years ago, 90 percent of the plans that my company, PenTec, administered were defined benefit plans. Due to extremely complicated laws and regulations, less than 10 percent of the plans PenTec currently services are defined benefit plans. The same change in ratios are found throughout ASPA's membership. During this same period, funding of employee benefits had shifted from the employer to the employee as illustrated by the growth in the 401(k) plans.

I congratulate the Chair and Congressman Pomeroy for introducing a simplified defined benefit plan that employers can use. The SAFE plan is the first congressional step since ERISA to establish a defined benefit pension program that is designed for small business employees. The SAFE plan is secure, fully portable and avoids most of the complex rules and regulations that choke small businesses that want to offer retirement plans for their employees. The unique feature of the SAFE plan is that in addition to a defined retirement benefit, it also gives employees the opportunity to obtain larger retirement benefits if plan assets perform better than conservative expectations. Further, the SAFE plan can provide employees with up to 10 years of credit for service prior to the start of the plan.

This allows for small business employees, in effect, to catch up with respect to the retirement savings. This is important because typically a developing small business cannot afford a retirement plan for several years. The catchup provisions of the SAFE plan are critical to the retirement planning of longstanding employees who helped build that small business. By contrast, defined contribution plans, like the new SIMPLE plan, do not allow for such catching up. Further, we are very disappointed in the administration's SMART plan proposal because it does not allow for any prior service credit. The security of the plan to the employees cannot be understated either. Under the SAFE plan, the small business must always fully fund employees' benefits.

Further, the SAFE plan proposal provides fully portable benefits, which is extremely important given today's mobile work force. Benefits are fully vested in automatic IRA conversions, plus high penalty taxes for early withdrawals increase incentives for employees to maintain their pension assets.

I congratulate the Clinton administration for supporting expansion of small business defined benefit plans by including the SMART plan proposal in fiscal year 1999 budget. Although there are many similarities between SMART and SAFE, there are some important differences that I'd like to highlight.

First, although SAFE requires no PBGC insurance, I do believe a modest PBGC premium could in fact enhance the marketability of the plan since it would give small business employees added security. However, such premiums should recognize the greatly reduced insurance risk to the PBGC and be substantially less than the PBGC current premium.

ASPA also agrees with the PBGC testimony that the small business defined benefit plan should guarantee an annuity form of benefit if elected by the participant. However, given the difficulties small plan sponsors have when purchasing individual annuity contracts, ASPA strongly suggests that this Subcommittee consider the proposal described in ACLI's testimony to allow the sponsor of the SAFE plan to select from a range of interest rates from 3 to 5 percent upon adoption of the plan. This would allow the SAFE plan to be funded at levels that more closely resemble the individual annuity market.

In addition, we would suggest that the PBGC be given authority to develop methods for small business owners to purchase individual annuities on a more competitive basis. For example, the PBGC could facilitate negotiating master contracts with insurance companies which could be used for small business owners sponsoring the SAFE plan. The annual limit on compensation that may be taken into account for benefit purposes under the SAFE plan is $160,000. The same limit in current law that applies to SIMPLE plans and all other qualified retirement plans should also apply to simplified defined benefit plans.

Under the SMART plan, the proposed annual compensation on it is only $100,000. ASPA strongly believes that there is not justifiable policy reason for imposing a special lower compensation limit. Because it is a defined benefit plan, benefits provided to the rank and file workers under both the SAFE and the SMART plans are significant and substantially greater than that would be provided under the SIMPLE plan. The owners of small businesses need an incentive to provide these greater benefits to rank and file workers.

I congratulate this Subcommittee's interest in retirement savings and thank you again for the opportunity to testify on this extremely important subject.

[The prepared statement follows:]

Statement of Michael Callahan, President, PenTec, Inc., Cheshire, Connecticut; on Behalf of American Society of Pension Actuaries

INTRODUCTION

Good afternoon. Thank you for inviting me today to testify on this important subject. My name is Mike Callahan. I am an enrolled actuary and president of PenTec, a pension consulting and actuarial firm located in Cheshire, Connecticut. PenTec provides retirement plan services to over 500 small businesses located in the state of Connecticut. I also am past president of the American Society of Pension Actuaries (ASPA) on behalf of whom I am testifying today. ASPA is an organization of over 3,000 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, particularly defined benefit plan coverage, to their employees.

As part of the Small Business Job Protection Act of 1996, Congress passed a number of pension simplification provisions intended to promote coverage under qualified retirement plans. ASPA supported these initiatives and applauds the efforts of the members of this Committee in obtaining their passage. However, the enactment of these changes was only a first step. 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 business 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 1995 were created by small business. However, because of the many impediments to small business retirement plan coverage, these workers will often find themselves without a meaningful opportunity to save for retirement.

ROADBLOCKS TO SMALL BUSINESS RETIREMENT PLAN COVERAGE

1. Excessive Regulation

Simply put, more regulation means fewer pensions. There are close to 4,000 single-spaced pages of regulations affecting retirement plans. In one instance, there are close to 200 pages of IRS regulations interpreting just one sentence in the Internal Revenue Code. The costs associated with interpreting and applying these regulations are enormous, particularly for small business because there are fewer workers among which to spread the cost. For example, the average cost of administrative expenses for defined benefit plans is approximately $157 per participant.[2] However, the cost per participant for a small business defined benefit plan can often be twice that amount. Given how few small businesses provide retirement plan coverage for their workers, ASPA believes that steps should be taken to reduce the administrative costs that a small business faces when establishing a retirement plan.

2. Present-Law Bias Against Small Business Plans

Surprisingly, there are a number of present-law rules which work to discourage small business from establishing retirement plans on behalf of workers. Many of these rules grew from a bias that small business plans were only established by wealthy professionals (e.g., doctors and lawyers) and that only the professional, and not the staff, 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. This is unfair and impedes the ability of small business to compete with larger firms when trying to attract employees.

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

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[1] General Accounting Office, *401(k) Pension Plans—Many Take Advantage of Opportunity to Ensure Adequate Retirement Income* Table II.3 (August 1996).

[2] General Accounting Office, *Private Pensions—Most Employers That Offer Pensions Use Defined Contribution Plans* Table II.7 (October 1996).

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.[3] 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.[4]

3. Unreasonable PBGC Insurance Premiums on New Defined Benefit 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. Given the pressing need to expand pension coverage for small business employees, particularly defined benefit plan coverage, ASPA strongly suggests that this Committee and the PBGC consider ways to reduce this unnecessary burden on new small business defined benefit plans.

Inadequacy of Defined Contribution Plan Benefits

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.

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[3] U.S. Department of Labor, *Private Pension Plan Bulletin—Abstract of 1993 Form 5500 Annual Reports* Table F2 (Winter 1997).

[4] The Advisory Council on Social Security also urged in its recently issued 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).

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.

SECURE ASSETS FOR EMPLOYEES ("SAFE") PLAN ACT OF 1997

I congratulate the chair of this Committee for introducing a simplified defined benefit plan which addresses these needs. The Secure Assets for Employees (SAFE) Plan Act of 1997, introduced by Reps. Nancy Johnson (R–Conn.), Earl Pomeroy (D–N.D.), and Harris Fawell (R–Ill.), creates a new safe harbor defined benefit retirement plan for small business which 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. Here are some details:

1. Fully Funded and Secure Retirement Benefit

- SAFE plan retirement benefits will be totally secure because they will be funded either through an individual retirement annuity ("SAFE Annuity") issued by regulated financial institutions or through a trust ("SAFE Trust") whose investments will be restricted to registered investment securities or insurance company products.
- SAFE plans will always have to be fully funded. The full cost of an employee's minimum defined benefit for each year of service is contributed to the SAFE plan by the employer when earned. Each employee will have an account—either with a SAFE Annuity or in the SAFE Trust—where plan assets will be held, and each year the employee will get an account statement, issued by the trustee, indicating the cash balance in the account and what the monthly benefit will be upon retirement (age 65).
- SAFE plans will be required to use specified conservative actuarial assumptions (e.g. a 5% interest rate assumption) to ensure the minimum retirement benefit. In the unusual circumstance where actual investment returns do not meet the conservative actuarial expectations, the employer (utilizing the SAFE Trust) will have to make a current contribution so that there are enough assets in each employee's account to fund the minimum defined benefit. With the SAFE Annuity, since the financial institution guarantees the minimum benefit, no such employer contribution would be required.

2. Minimum Defined Benefit With Possible Higher Benefit

- SAFE plans utilize the best features of both defined benefit and defined contribution plans by providing a fully funded minimum defined benefit, plus a higher benefit if investment returns exceed conservative expectations. With the SAFE Annuity, this is achieved by using individual participating deferred annuities which would have to guarantee the minimum defined benefit but also would have to give some opportunity for a higher benefit based on investment performance. In the case of a SAFE Trust, if the average return of the assets in the employee's account exceed the required conservative interest rate assumption (5%), the employee will receive a higher benefit.
- At a minimum, employees will receive a benefit equal to 1%, 2%, or 3% of compensation for each year of service. For example, if an employee whose average salary was $40,000 has 25 years of service for an employer who elects a 3% benefit, the employee will retire with a minimum $30,000 annual benefit (which could be higher depending on investment performance). If the small business runs into financial difficulty in any year, it can elect to reduce the minimum benefit to 2% or 1%, or even zero. The percentage benefit in any year must be the same for all employees.
- In order to allow baby boomers to catch-up with their retirement savings, employers can elect to credit benefits for up to 10 prior years of service, provided such benefits are credited to all employees eligible when the plan is adopted and the prior service is funded over an equal number of years (e.g., funded over 5 years if the employee has 5 years of prior service). The full cost of the benefit for each year of prior service is funded at the same time as the benefit for the current year of serv-

ice. Prior service could not be granted for prior years when the employee was covered under another defined benefit plan.

• An employee's benefit is 100% vested at all times.

3. Fully Portable Retirement Benefit

• Employees participating in the SAFE Annuity who separate from service automatically hold an individual retirement annuity that will pay them at least the benefits they have earned (and possibly a higher benefit) upon retirement. They can even choose to continue to fund the annuity themselves, and thus increase their retirement benefit, in accordance with current-law Individual Retirement Account ("IRA") rules.

• Employees participating in the SAFE Trust will have their retirement benefits automatically converted to a SAFE Annuity, or, if they elect, have the cash balance in their account transferred to an individual retirement account (a "regular IRA"). Either can continue to be funded under current-law rules.

• The benefit in a SAFE Annuity may be rolled over to another SAFE Annuity without restriction. However, in order to ensure adequate benefits for retirement, benefits in a SAFE Annuity and SAFE Trust will be subject to substantial early distribution restrictions.

4. Easier to Administer

• SAFE plans will have simplified reporting requirements, including a simplified actuarial report verifying that the employer satisfied the annual funding requirement.

• SAFE plans will not be subject to complicated nondiscrimination rules or plan limitations. However, so that plan benefits are distributed fairly to all employees, SAFE plans, like SIMPLE plans, will be subject to the current-law annual limit on employee compensation ($160,000).

• Since SAFE plans are always fully funded using conservative actuarial assumptions, Pension Benefit Guarantee Corporation ("PBGC") insurance premiums are not required.

5. Complements the SIMPLE Plan

• SAFE plans can be used with SIMPLE plans or 401(k) plans. However, no other defined benefit pension plans can be maintained if an employer maintains a SAFE plan.

• Employer eligibility, employee eligibility, and the definition of compensation are the same under the SAFE plan as under the SIMPLE plan.

• As with SIMPLE, employers using a SAFE Annuity can designate a financial institution.

SECURE MONEY ANNUITY OR RETIREMENT TRUST ("SMART") PLAN PROPOSAL

I also congratulate the Clinton administration for supporting the expansion of small business defined benefit plan coverage by proposing the SMART plan. The SMART plan, which is heavily based on the SAFE plan proposal, is also a simplified defined benefit plan.

Although there are more commonalities than differences between SAFE and SMART, there are some important distinctions. These differences could have a serious impact on the attractiveness of a simplified defined benefit plan to small businesses. ASPA certainly believes that any simplified defined benefit plan developed by Congress must be one that will be embraced by small businesses.

Following are some of ASPA's views regarding the more significant differences between SAFE and SMART:

1. PBGC Insurance Premiums

As indicated previously, given the fully funded nature of the SAFE plan, the SAFE plan does not require small businesses to pay PBGC insurance premiums. The SMART plan proposal, however, would require the payment of "reduced PBGC premiums," although the exact amount has not been specified by the Clinton administration.

ASPA believes that given the design of the SAFE plan, which must always be fully funded with specified conservative actuarial assumptions, the risk of loss to participants is extraordinarily small. Nevertheless, a reduced PBGC premium might enhance the marketability of the plan to small business since benefits would be protected even in the small likelihood of a loss to participants on plan termination. Consequently, ASPA would not have an objection if either SAFE or SMART (in the qualified plan form) required PBGC insurance premiums, provided such premiums recognize the greatly reduced insurance risk to the PBGC and are substantially less than the current premium of $19 per participant.

2. Conversion of Participant's Account Balance to Individual Annuity at Retirement

Under the SAFE plan proposal, benefits at retirement age (i.e., age 65) are based upon the amount in the employee's account. The employee can elect a lump sum or annuity purchased with the balance in the employee's account. Given the conservative actuarial assumptions, in most cases the employee should receive a benefit higher than the benefit under the plan, whether in the form of a lump sum or annuity. However, in certain circumstances, if the employee elects to receive benefits in the form of an annuity, it is possible the amount in the employee's account will be insufficient to purchase an annuity providing the employee's specified benefit. This is because the market for purchasing annuity contracts on an individual basis is extremely inefficient. Because small businesses have minimal purchasing power, it is often impossible to find an insurer willing to sell a competitively priced individual annuity contract. For example, as the ACLI will testify, it is unlikely an insurer would offer an annuity with a 5% rate of return. It is more likely that a lower rate of return would be available, which raises the cost of the annuity.

In practice, this issue generally will not cause problems for the following reasons: a) most employees will elect to receive their benefits in a lump sum rolled over into an IRA; and b) excess earnings allocated to an employee's account should offset the higher annuity costs.

Nevertheless, the remote possibility does exist that the employee's account will not have enough to purchase the promised annuity. The SMART plan proposal addresses this by requiring the owner to contribute extra money to the employee's account at retirement, above the annual funding requirement, to pay for any shortfall that may exist should the employee elect an annuity. With SAFE, I understand that it was decided not to do this because there was concern small business owners would be discouraged from adopting the plan if faced with this possible additional liability.

The PBGC, in its testimony, emphasizes this distinction between SMART and SAFE. They characterize the issue by stating that "SMART is a true DB plan," and implying that SAFE is not. While ASPA strongly disagrees with this characterization, ASPA does agree that it would be preferable if participants could elect to receive an annuity paying the full amount of their specified benefit in every instance. Consequently, ASPA would not object if the approach used in the SMART plan proposal to address this issue was incorporated into the SAFE plan. However, given the difficulties described earlier that small plan sponsors have when purchasing individual annuity contacts, ASPA strongly suggests that this Committee consider the proposal described in ACLI's testimony to allow the sponsor of the SAFE plan to select from a range of interest rates from 3% to 5% upon adoption of the plan. This will allow the SAFE plan to be funded at levels that more closely resemble the individual annuity market.

In addition, we would suggest that the PBGC be given authority to develop methods for small business owners to purchase individual annuities on a more competitive basis. For example, the PBGC could facilitate negotiating master contracts with insurance companies which could be used by small business owners sponsoring a SAFE plan.

3. Employer Eligibility

Like SIMPLE plans, SAFE plans can be adopted by employers with 100 employees or less. The SMART plan proposal uses the same approach, except professional service employers are excluded and a SMART plan may not be adopted if the employer maintained another defined benefit plan within the last five years. ASPA strongly disagrees with these limitations.

There is no sensible tax policy that justifies excluding professionals from eligibility. If the concern is potential abuse, the SAFE plan has built-in design features like caps on the available benefit formulas and limits on the amount of annual compensation (i.e., $160,000) that are taken into account which prevent such abuse. The fact is, some non-professionals, like skilled tradesman, often make more than so-called professionals in today's workforce. As long as everyone is on a level playing field in terms of plan design, a group of employers should not be excluded simply based on what business they are in.

Similarly, a small business should not be punished for previously offering a defined benefit plan. The SMART plan proposal does this by not allowing adoption of the SMART plan if the employer had a defined benefit plan in the last five years. If the Clinton Administration is concerned about individuals doubling up on benefits, ASPA believes the approach taken by the SAFE plan is the better approach.

Under the SAFE plan, employees are not allowed prior service credit for years they were previously covered under a defined benefit plan.

4. Past Service Credit

One of the chief policy goals of the SAFE plan proposal is to allow small business employees who have not previously been able to save sufficiently for retirement to catch-up with respect to their retirement savings. Defined benefit plans are ideally suited for this because they can provide benefits to employees for years of service prior to adoption of the plan. The SAFE plan accomplishes this by allowing a small business to give current employees up to 10 years of past service credit. To encourage the small business to maintain the plan, such past service credit would have to be funded over an equal number of years (e.g., 5 years of past service would have to be funded over 5 years).

Unlike traditional defined benefit plans and the SAFE plan, the SMART plan does not allow for any past service credit. In ASPA's view, small businesses will simply not adopt the SMART plan unless it allows small business employees to catch-up with respect to their retirement savings. The SMART plan attempts to compensate for the lack of past service credit by allowing for an additional 1% benefit during the first five years of the plan. However, this is completely inadequate since it does not allow the small business to reward existing employees who have contributed to the development of the small business prior to adoption of the plan.

5. Compensation Limit

The annual limit on compensation that may be taken into account for benefit purposes under the SAFE plan is $160,000 (indexed). This is the same limit in current law that applies to SIMPLE plans and all other qualified retirement plans.

Under the SMART plan, the proposed annual compensation limit is $100,000. ASPA strongly believes there is no justifiable policy reason for imposing a special lower compensation limit. Because it is a defined benefit plan, benefits provided to lower-paid workers under both the SAFE and SMART plans are significant and substantially greater than what is provided under the SIMPLE plan. The owners of small businesses need an incentive to provide these greater benefits to lower-paid workers. However, the compensation limit will potentially reduce the small business owners' benefits. Simply put, given the significantly greater benefits for lower paid workers under both SAFE and SMART, lowering the compensation limit is going in the wrong direction and the compensation limit under SMART should at least be the same as under SIMPLE and current law.

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.
- Most 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 of 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 less 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. A generational economic conflict is inevitable unless immediate action is taken.

We believe there is need for constructive pension reform, particularly with respect to small business retirement plan coverage. We believe that the time has come to enact comprehensive legislation which will provide an opportunity for all working Americans to obtain financial security at retirement.

Mrs. JOHNSON of Connecticut. Thank you very much.

It's a pleasure to welcome you, Mr. Fradette from Bristol, Connecticut, to today's hearings. I'm glad you were able to make it.

STATEMENT OF GREG FRADETTE, SR., GREG FRADETTE AGENCY, INC., BRISTOL, CONNECTICUT

Mr. FRADETTE. Thank you, Madam Chairman. Thank you for inviting me to testify before your Subcommittee today. I appreciate this opportunity to explain why current pension laws have made it difficult for me to offer complete retirement for my employees.

My name is Gregory Fradette and I am owner and founder of the Greg Fradette Agency—a 10-year-old insurance agency located in Bristol, Connecticut. I currently employ 13 people—many of whom have been with me for a number of years. The Greg Fradette Agency sells a wide variety of insurance products. Business customers represent approximately 85 percent of our client base. And as you are well aware, Madam Chairwoman, Connecticut is home to many small manufacturers. These manufacturing companies represent the backbone of our agency, accounting for half of our business.

Although we are a small business, I am proud of the level of benefits that we offer our employees. Comprehensive health insurance, including prescription drugs and dental coverage, life insurance, short-term disability income, paid vacation, flextime and a matching 401(k) plan are all part of the standard benefit package of the Fradette Agency. In addition, our agency has had five babies in the last 10 years. We're happy to say that we were able to accommodate our young working mothers with a flexible work schedule. All of our soon-to-be soccer moms are back to work full time. Thanks in large part to the efforts of our employees, business is good.

I'd like to expand the retirement package to include a traditional defined benefit pension plan. Currently, participants in our 3-year-old 401(k) plan can contribute up to 3 percent of salary, and we will match that by 50 percent. While I am pleased with the success of the 401(k) plan so far, I recognize that this will not generate a sufficient amount of retirement income for either myself or my older employees. That is why I am researching the feasibility of establishing a defined benefit pension plan.

However, I am told that the complex regulations of current pension law would make it very costly for me to establish a plan that would provide a more adequate retirement income for my employees. Large employers can spread these administrative costs over a large number of employees. I don't have that luxury. Establishing a traditional pension plan is cost-prohibitive for me at this time. That is why I support your SAFE plan proposal, which will allow me to adapt a small business defined benefit plan with significantly reduced administrative costs.

I am blessed with dedicated, hardworking employees, and I would like to provide an affordable pension plan for them, but in order for me to do so, the laws need to make it possible for small employers like me to establish such affordable plans.

On a personal note, Madam Chairwoman, from 1986 to 1994, my wife and I paid to send our three children through college. We're proud of the fact that all three graduated. But college tuition, along with the startup costs of my agency, used up all our savings. Now, at age 50, I have to start saving for our retirement. So please enact the SAFE plan proposal as soon as possible, so that my employees and I can start saving adequately for our retirement.

And thank you again for the opportunity to testify today, Madam Chairwoman.

[The prepared statement follows:]

Statement of Greg Fradette, Sr., Greg Fradette Agency, Inc., Bristol, Connecticut

Madame Chairman, thank you for inviting me testify before your subcommittee today. I appreciate this opportunity to explain why current pension laws have made it more difficult for me to offer complete retirement benefits to my employees.

I am owner and founder of the Greg Fradette Agency, a 10 year old insurance agency located in Bristol, Connecticut. I currently employ 13 people, many of whom have worked for me for years. The Fradette Agency sells a wide variety of insurance products, about 85% of which is to commercial customers. As you know, madame chairman, northwest Connecticut is home to many small manufacturing companies. My agency has a close working relationship with many of these companies, who represent over half of my overall business.

As a small business owner, one thing I am proud of is the level of benefits I offer my employees. Comprehensive health insurance, life insurance, paid vacation, profit sharing, and a 401(k) plan with employer matching contributions are all part of the standard benefits package at the Fradette Agency.

However, now that my business has become more established, I am in the position to expand the retirement package that the company offers to include a traditional defined benefit pension plan. Currently, participants in our three-year-old 401(k) plan can contribute up to three percent of salary, which is then matched fifty cents on the dollar by the company. Over two-thirds of my employees participate.

While I am pleased with the operation and success of our 401(k) plan so far, I recognize that this will not generate a sufficient amount of retirement income for either myself or any of my older employees. Therefore, I am researching the possibility of establishing a defined benefit pension plan. However, I am told that under current law, complex regulations make it not very cost-effective for me to establish such a plan which will provide a more sufficient retirement income for my employees. Because I can spread the administrative costs over fewer employees as compared to a large employer, setting up a traditional pension plan is cost-prohibitive for me at this time. That is why I support your SAFE plan proposal which will allow me to adopt a small business defined benefit plan with significantly reduced administrative costs.

I am fortunate to have dedicated, competent employees working for me, and I want to be able to provide this benefit to them. But in order for me to do so, the laws need to make it possible for small businesses to establish plans in a cost-effective way. Please enact the SAFE plan proposal as soon as possible so that baby boomers like me and my employees can save adequately for retirement.

Thank you for the opportunity to testify today, madame chairman.

Mrs. JOHNSON of Connecticut. Thank you very much.

I apologize to those members of the panel whose testimony I was unable to hear, but also to Mr. Strauss, and I thank my colleague, Mr. Portman, for starting this hearing.

You may have read in the newspapers of the terrible incident in Connecticut where four State employees were killed by an angered member of their group, and I mention that because people who serve in government are important to all of us. A good functioning government is essential to a free society, and some of those who do serve, our citizens, do often run a lot of risk from the public they deal with, but also in the constraining governance of employee problems that we all live with. And so it was my not only obligation, but personal responsibility to be at the funeral of my friend and compatriot, Linda Laganowski, former mayor of New Britain, my hometown, who was one of those, but also to take part with the Governor in recognizing the service of these individuals to our State and the tragedy of their death. They were all extraordinary people. It was tragic to read of their lives left behind—spouses, children, volunteers in their community, coaches of little league, all the things that we know make a difference in building our communities and assuring the strong families that we know are the heart and soul of a free society.

So I'm sorry that I had to be late, and I appreciate the help of my colleague, Mr. Portman, and the indulgence of all of you.

I would like to, first of all, commend you, Ms. Shaffer, on the pamphlet, "On Women's Retirement." I did have a conference on women and investing recently, had a very small turnout, but it was really interesting some of the people who came. Women are beginning to realize that they have a responsibility to plan for their own retirement, whether they're single or whether they're married.

I also appreciate some of the comments that those who testified made in regard to the differences between SAFE and SMART, and I want to concentrate my questions on two aspects of the differences between SAFE and SMART, and then throw out one other question.

First of all, SAFE allows 1 to 3 percent, a program that would provide 1 to 30 percent of income to be saved each year. The SMART program is less generous, both in threshold of $100,000 and in the use of the 3 percent. When you look at the calculations from each plan, neither plan is talking about more than, say, about 30,000 a year or 22,000 a year, I think is what most of them are. Now 22,000 a year with a relatively low Social Security benefit is not a lot, looking to the future. So it seemed to me unwise to limit the 3 percent option as it is limited in SMART. That's one issue I'd like to hear your thoughts on.

Second, I was very interested, Mike, that you think the pension guarantee benefit premium is a good idea. I'd like to hear other people's thoughts on that, but it seems to me unnecessary to ensure a fully funded plan.

And then, last, on the issue of spousal consent, that has become kind of a two-edged sword. I have an employer who came to me just last week saying that he must have these spousal consent forms because they're making changes in their plans, but now some of the families that are having difficulty don't want to get them. And these are women who don't want to deal with their spouse about this, for a variety of possible reasons. So that is an issue.

Incidentally, I also want to acknowledge my colleague and friend, Earl Pommeroy, who is with us, and will have a chance to question after the Subcommittee Members do so.

So if you could comment on the 3 percent issue, the pension benefit guarantee fund premium, for those of you who didn't comment on that, and the issue of spousal consent. Is it time that we begin to look at that differently? Maybe if your other spouse has a pension at his place of his business that comes out of his wages or his determination—you know, how do we begin to look at spousal contributions now in the sense of ownership that I see in lots of women in all ages of their benefits, sort of in the new world?

When we got that spousal consent—and I remember sitting at the White House when Reagan was President, and we, on a bipartisan basis, got this change in the law, it was primarily because women weren't working; men were the ones who were working, and whether or not their husbands' pension planned allowed or assured that choice was a very, very important issue. When both people are working and have different options for retirement benefits, we need communication and agreement perhaps, but do we see the spousal benefit exactly the same way for the next 50 years that we saw it, say, 10 years ago?

Ms. SHAFFER. Well, obviously, it's a very complex issue, and it is true that working women now are more present in the work force than ever before. But when you cite the average pay equity statistics for women in the work force, which have been compounded in retirement to create a retirement gender gap, I would think that at this point in time, for the average woman, we would want to err on the side of disclosure and spousal options. Because those women, in general—and there are, obviously, exceptions—are still going to be earning less than their male spouse, are going to have given up years in the work force for care giving responsibilities. This formula will affect their retirement benefits, as well as, their Social Security benefits—all three legs of that retirement planning stool, and, in general, those factors would still create a real disadvantage for women not having choices, not having participation in those choices, because they are going to likely earn less than their husband.

So to the extent that women and their families are dependent on these options, we need, I think, at this point to preserve them. Obviously, as time goes on, if the pay gap erodes to the point where we have more parity, more equity, perhaps this will be less of an issue, but these factors for working women truly exacerbate their vulnerability in retirement.

And, incidentally, some of those poverty statistics that I quoted, comparing particularly single women in retirement and single men in retirement, for example—I shortened my remarks because of the time constraints, but there's a chart showing that the United States of America has a higher rate of single women living in poverty than any of the industrialized nations. That truly gives one cause for concern and kind of puts that in perspective. Hopefully, there will be a point in time where maybe those issues should be revisited, but I think we need to err on the side of spouses having an opportunity to participate in the decision—and certainly in divorce situations, spouses knowing before divorce agreements are finalized—what rights and options they may have to exercise.

I also wanted to correct one impression. I cited this pamphlet, but it is not a BPW publication. It is a project of WISER, Women's Institute for a Secure Retirement, and the Heinz Foundation. We are helping to distribute it to all our members across the country, and we commend WISER for producing this.

Thank you.

Mrs. JOHNSON of Connecticut. Thank you. Anyone else want to comment on the other issues?

Mr. LEONARD. I would like to comment on that, too. Enforcing what Gail said, my wife works full time; I work full time. I make 70 percent of the income; she makes 30 percent. So if she did not have the opportunity to investigate pensions and have spousal consent, she would be in the same type of trouble that Gail mentioned.

Mr. CALLAHAN. At PenTec, Madam Chairwoman, we probably process somewhere close to 4,000 to 5,000 distributions annually, and though there's an administrative cost or burden that's associated with that, we don't really see very many problems with getting those spousal signatures. I think in terms of looking at those spousal signatures and ensuring that there's a knowledgeable decision that's made, it certainly relieves the employer of some fiduciary responsibilities, and it's knowledge that's being gained by having those spousal signatures. So I agree with Ms. Shaffer. I think it's not time yet.

Mrs. JOHNSON of Connecticut. What about the issue of the 3 percent option?

Mr. MEROLLI. I'd be happy to comment on that. I don't feel, quite honestly, that the 2 percent is sufficient. The SMART minimum defined benefit is either 1 or 2 percent, and it increases to 3 only during the first 5 years of participation. SAFE is 1, 2, or 3 percent, and you can use 10 years of past service as well.

If you're a gentleman like Mr. Fradette, and your children have gone through college, you're 50 years old now, and you want a simple way to save a lot of money in a short period of time. I think taking into account the fact that you can go up to 3 percent benefit times years of service and use up the 10 years of past service means that you can catch and you can fund an adequate benefit for your own retirement now that you have put your children through school. I think $160,000 compensation limit also ties in with that, and I think it's much more beneficial and much easier to handle than $100,000 cap.

We deal with small plans all the time. We have 1,400 plans that we act as third-party administrator for. Our defined benefit total has shrunk to less than 100, and a lot of those folks, like Mr. Fradette, are right now, if they want something simple, they have to stay with defined contribution. I think with using SAFE, with 10 years of past service and a 3 percent annual rate of accrual is the way to go.

Mrs. JOHNSON of Connecticut. Thank you. There's a very, very important point. This Subcommittee changed the pension laws in regard to teachers last year, for exactly that reason. They have buyback rights, but they were capped, and you can't exercise your buyback rights because you don't have any money to buy back until later in life, when your children have finished college, and then they were limited as to how much they could buy back, even though the buyback was absolutely legitimate, and something they had earned.

So this one goes not necessarily to the pattern of women's lives, but to the pattern of our lives—men and women. There are years when you have disposal income, and there are years when you don't. If we limit these pension plans so that you can never save more than a rather minimal amount, then we limit retirement benefits as well. So that's interesting.

Mr. Coyne, I'd like to yield to Mr. Coyne for questioning.

Mr. COYNE. Thank you, Madam Chairwoman.

Mr. Fradette, in your testimony you mentioned that two-thirds of your employees are participating in the 401(k) plan. One of my concerns is that the pension system that we're currently under has a lot of employees who are unwilling or unable to participate in plans, 401(k) plans, just like some of your employees.

I wonder if you could tell us, not just in your company, but generally, who are the individuals that make up the one-third that don't participate? Are they people who are low-income workers or short-term employees? Do you have any sense of that?

Mr. FREDETTE. Well, in our particular case, we're dealing with just 13 employees, and there are 2 or 3 who aren't participating. They're fairly young, and at this particular point I think they'd just as soon take all the income, and hopefully, as time goes on and they become more secure in their job, they'll see the light and participate in the 401(k), but that's really what's going on right now at our agency.

Mr. COYNE. It's the younger employees who maybe feel that they don't have the resources to be able to contribute——

Mr. FREDETTE. Exactly.

Mr. COYNE [continuing]. Into the 401(k) plan?

Thank you.

Mrs. JOHNSON of Connecticut. Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair. I have a lot of questions. I really appreciate all the expert testimony.

My first question is really a basic one, which is: Who's going to use this plan? How popular is it really going to be? We've heard a lot of good testimony today about how the SAFE or SMART or SMART/SAFE plan might be important. I talk to a lot of small businesses who are interested in some kind of retirement savings plan, but they're not sure if they can get into a defined benefit plan. They're more interested in a SIMPLE type plan. And I wonder if any surveys have been done, if you all have talked, on an informal basis with your plan participants? You said, Mr. Merolli, I think you have over a thousand plans you work with; and, Mr. Moore, you work with a lot of plans around the country. Is this going to be something that will be popular?

Mr. MEROLLI. I think it will be very, very popular. We have a lot of baby boomers, myself included, who have reached a point, like Mr. Fradette, and they need to save a lot of money in a very, very short period of time, and the complexities of present-day defined benefit law have basically shied them away from it, and I think it's going to be a very, very strong market. I feel better about this than I did about SIMPLE, and SIMPLE's been pretty good.

Mr. MOORE. I'd share that assessment. I think it will be attractive to the small employer and the small business employee.

And I wanted to tie in one point that was raised earlier about the catchup provision of the 3 percent. I think this is another reason it's attractive. If you're a younger person, as was pointed out, and maybe you're not participating now, and you get to be 40 or

50, and you realize you should have been catching up. There might be a tendency to make what would be riskier or high-risk investments.

Mr. PORTMAN. Yes.

Mr. MOORE. This provides a very equitable and safe mechanism for you to catch up by recognizing past years of service. It's a very safe plan for all of us, and I think it's a great opportunity for somebody to catch up in a fair manner.

Mr. PORTMAN. Mr. Callahan.

Mr. CALLAHAN. Congressman Portman, there are some rules of thumb that I'm going to provide just as a general approach. If you take a look at a person who's about 20, 22 years old, a 2-percent-of-pay-per-year contribution provides him adequate retirement income. When you get to 30, it jumps to about 6 percent of pay. When you get to 40, it increases to close to 20 percent of pay. And when you get into your fifties, you're now looking at a program that you cannot have under our current system. So that leaves us with a real problem at retirement age because people just can't accumulate enough.

In addition to that, people don't really know what the conversion is: How much do they need? The number here was somebody earning around $28,000 needs one-quarter of a million dollars to retire. Most employees don't understand that number. They think if they have $50,000 or $60,000 that they've accumulated over their lifetime, that that's going to last them for 20 years. It's not enough. It's not even close to being enough.

So what we're going to find is some generational gaps where people are just going to live longer than what they have available to them, and it's going to be a substantial curtailment in their lifestyle. This kind of program, which has a guaranteed benefit, a floor benefit with an upside to it, provides that guaranteed minimum benefit. People understand that. They know what their monthly benefit is, and when added to Social Security and some personal savings, can provide an adequate retirement income. That's why this is so important.

Mr. PORTMAN. I think those are adequate responses. I share those. My question was in a way a devil's advocate question. I think it's time for us to really fill a gap, a major gap, and part of it is that young people think they're going to live forever, as many of us did, I'm sure, didn't prepare, and when you get to be a baby boomer, my age, over 40, you begin to realize you need to catch up quickly, and it's difficult to do so with a defined contribution plan.

With regard to the PBGC guarantee, I think, Mr. Merolli, you had some strong views on that. It wasn't necessary. Mr. Moore, I think you thought it was important, which is, as you know, contained in the SMART plan, not the SAFE plan.

I guess one question I would ask for the panel, and maybe quickly those of you who are out in the business of marketing plans or have been involved with companies that are looking for these kinds of plans, Mr. Strauss made the point that he had talked to at least—he mentioned one person in the business who said this was going to be a great marketing tool because companies would be much more likely to pick up a plan like SMART or SAFE if they knew the Federal Government was behind it. Is that your experience? And how does that balance with the premium responsibility?

Who'd like to take a crack at it first? Mr. Moore, maybe first, and then Mr. Merolli.

Mr. MOORE. I generally share Mr. Strauss' assessment. I think you have to look at it from the perspective of who's going to be participating also. If there is a sense of security that the PBGC stands beside that, then it's going to be very easy for the employer, quote/unquote, "sell his program." So from that sense, marketability, yes, absolutely.

Mr. PORTMAN. OK, Mr. Merolli.

Mr. MEROLLI. Up until now, PBGC premium, the requirement to be in PBGC has not been a positive as far as a marketing standpoint because it's added a lot of complexity. PBGC forms are pretty extensive. And currently, professional service employers of under 25 employees are exempt from PBGC anyway. If you're a small business with just a couple of people and no rank-and-file workers as well, you don't have PBGC coverage currently, and that system seemed to be working pretty well. If we wind up with PBGC coverage, though, it should be a really nice, simple, little form like one little simple page with a really tiny, little premium.

I think it has in the past been an added expense. It's discouraged and it's made defined benefit plans unaffordable for a lot of small employers, particularly the ones we've been trying to hit at. That's been our experience.

Mr. PORTMAN. He told us today a number. It wasn't in his testimony, but in his oral response he said five dollars. Is that a nice, little, tiny amount?

Mr. MEROLLI. I would consider that a nice, little, tiny amount.

Mr. PORTMAN. Mr. Callahan.

Mr. CALLAHAN. I think we have to look at who's our customer. Our customer for these retirement benefits is a plan participant. From the employer's perspective, it's a hidden tax, especially if they have to make this as a fully funded benefit. From the customer's point of view, from the plan participant, having that added security of providing that minimum benefit, I think it's important issue.

So when we take a look at who's the ultimate beneficiary of this and who's our ultimate customer, I see that——

Mr. PORTMAN. But the question is, who is the customer? Who's going to be making the decision to go into these plans? I guess in many cases the employees are going to go to the employer and advocate for such a plan. So maybe, in a sense, they can be the indirect customer, but in most cases I would guess it's the employer making the decision.

Mr. CALLAHAN. I don't think it's an insurmountable barrier, but as a hidden tax, it can be——

Mr. PORTMAN. How do you come out on the type of plans we're talking about here, the SAFE plan, for instance, do you think it needs to have the PBGC guarantee?

Mr. CALLAHAN. I'm sorry, would you say that again.

Mr. PORTMAN. How do you come out on the issue?

Mr. CALLAHAN. I think it's reasonable to have a PBGC-backed guarantee as long as——

Mr. PORTMAN. You would prefer to have one?

Mr. CALLAHAN. If it's small. If the guarantee is for the full benefit, the remaining full benefit, and the premium is small, then, yes. If it's the current guaranteed benefit premiums, I don't think that offers.

Mr. PORTMAN. OK. Thank you. Thank you for your help today.

Mrs. JOHNSON of Connecticut. Mr. Kleczka.

Mr. English.

Mr. ENGLISH. Thank you, Madam Chair.

This, it seems to me, is a very important topic, and we appreciate a panel of this distinction being here to explore it. What we have learned is that, increasingly, the experience of employees is going to be a little different than it has been in the past. More and more, people will be going to different employers during the course of their career, and it's estimated in the next century that it's going to be relatively common for someone to have five or six different employers during their lifetime.

So I wanted to focus a little bit on portability. In your view, can the law be improved to give participants in defined benefit plans the same portability features as the participants in defined contribution plans? Who would like to comment on that? Mr. Leonard?

Mr. LEONARD. Yes, thank you very much. The IEEE has been advocating pension portability since about 1974. I think the SAFE plan, as you're proposing it, is an excellent way to provide portability to small companies. Our engineers are looking at the same thing you mentioned—seven or eight job changes throughout their entire career. The engineer that goes to work for one company and stays there until he retires is gone. Maybe I'm the last one, but there aren't many left. Even some engineers are starting their own consulting firms right out of school.

So, for small companies, a SAFE plans is what we need. For large companies, an ability to transfer their pension from one company to another company by possibly Trustee to Trustee transfer, maybe be a method of examining pension portability or defined benefit plans for large companies.

Mr. ENGLISH. Mr. Leonard, how does your organization feel about, putting the SAFE and SMART proposals side by side, how do you feel about the $100,000 limit specifically that's built into the SMART plan?

Mr. LEONARD. I'd say I don't like it. I'm more for the $160,000 limit. And if I might comment further, we are for the SAFE plan. The SMART plan has a clause in it that excludes our type of professionals working as service employees. So IEEE would be for the SAFE plan.

Mr. ENGLISH. I'd open this up to the other panelists, on how you feel specifically on the portability end, how the SAFE and SMART proposals stack up against each other, and what features you're particularly attracted to in either?

Mr. Merolli.

Mr. MEROLLI. Yes. Thank you. The beauty about the SAFE plan is that each participant's benefit, unlike a traditional defined benefit plan, which is a pooled account, in SAFE each participant's benefit is kept in their own separate account. So all the benefits are, and should remain, totally portable. When the individual terminates from employment, for example, either a SAFE annuity or the SAFE trust can be transferred to a SAFE annuity or to a traditional IRA, for example, or the 20-percent penalty tax is paid. The 20-percent penalty tax, obviously, discourages people from taking their distributions before retirement, and the SAFE is structured this way, so that it becomes totally and fully portable. And that's the beauty we like about it, and that's the advantage it has over the traditional defined benefit plan.

Mr. ENGLISH. Any other comments from the panel?

Ms. SHAFFER. Well, I would reiterate, from the point of view of BPW/USA, that one of the features we applaud in the SAFE plan is the portability. As I indicated, women tend to stay in a particular job on average for a lesser period of time than their male counterparts. They sometimes don't even vest in that job because of that, which is unfortunate. The average woman worker will lose during her career 11.5 years in the work force, most often because of care giving needs, she has to leave the work force and then come back again. So, certainly, both with the care giving absences from the work force that are particularly imperative sometimes for women, and the tendency on the average for them to change from job to job more often, portability is a very, very important feature. So we very much applaud that in the SAFE plan.

Mr. ENGLISH. Well, I would at this point, my time having expired, like to thank the panel, but also add, since I haven't had the opportunity to do so publicly before, I would like to thank the Chair for sponsoring this hearing, which I think is one of the most important that we have had, not only in the Subcommittee, but the Committee as a whole.

I want to compliment you specifically, Madam Chair, on your leadership on this issue and building a bipartisan coalition to focus on some of these very difficult pension issues, and I want to compliment you very much for your effort in this area, and thank you for the opportunity.

Mrs. JOHNSON of Connecticut. Well, thank you very much, Mr. English. There has been a lot of interest among the Members of the Subcommittee in this issue, and we've talked about it now for quite a while, and this is the first of two hearings, out of which we hope will come some substantial advancements in the opportunity for people to create retirement security for themselves.

Mrs. Thurman.

Mrs. THURMAN. Thank you, Madam Chairwoman.

Mr. Moore, we've received a report actually from some of our colleagues—I've lost in it in the myriad of paper up here—but, anyway, that while we know that about half of the employees have pensions. The other significant issue in there, though, is that around 21 percent of them actually make maximum contributions to this.

How do we change that culture of have fun now and wait for Social Security later, or maybe you'll have enough later on in your life? What do we do to look at this issue?

Mr. MOORE. I'm sorry, I think I might have missed part of your question. Were you saying that they're spending the moneys in their——

Mrs. THURMAN. Well, even if they have a pension plan available to them, in fact—only about 21 percent are actually contributing their full amount that they could contribute anyway.

Mr. MOORE. I think that SAFE goes a long way toward helping people not only focus on the importance of retirement, but making it easy for them to do. The biggest problem I see is the fact that we actually run across the converse problem, and we probably deal with anywhere between 3,000 and 5,000 phone calls and letters a year about problems with pensions. The biggest problem is that they just don't have money to set aside.

The problem you're describing with us tends to be a very small problem. I think people are very conscious of what their retirement needs are. Unfortunately, there are a lot of other competing needs that are much more immediate. Buying a house, any sort of child needs sometimes arise, special circumstances, and those things take precedence, and they are immediate, whereas retirement is further down the road. It's the classic case of robbing Peter to save Paul, but in this instance you're one and the same; you're Peter and Paul.

And the problem for us is, how do we get a structure that limits—and one of the nice things about SMART, there is a substantial distribution, early distribution, penalty, to let people say, stop, wait a second, is this really important enough to jeopardize your retirement future? And in those instances where it is you go ahead. But I think the real fundamental problem is that it's not a lack of awareness of people's parts here; it's a lack of an ability to have access money. They just don't have it.

Mr. CALLAHAN. Mrs. Thurman, I provide enrollment meetings to different companies. During the course of 1 year, I probably do 40 or 50 enrollment meetings personally to companies' participants. There are a couple of things that I find that people are just not aware of. One, that there was supposed to be a three-legged stool for retirement purposes in the United States: Social Security, an employer plan, and their own contributions. That's clearly not understood at all. They never knew that they were supposed to take responsiblity for of their retirement income. No one really knew who was supposed to take care of it, but they never knew that they were responsible for one-third.

Second, most knew somebody at one time that might have had a defined benefit pension plan, but those plans are all gone now, and nobody really takes care of pensions anymore. People believe they'll figure it out and do what they have to do.

We often have the discussion about the fourth leg to our retirement stool in the United States, in our employee enrollment meetings. And that fourth leg is really supplementing your income through continued working past retirement. So we now have, just by its nature of our policy here, developed that fourth leg of continued working.

The shift over to the 401(k) plans is a clear indication to anyone looking at policy issues that we have shifted the entire responsibility for retirements for our future generations over to the employees, and this is one of the first chances to shift it back.

Ms. SHAFFER. I would also like to add the comment that, if we want to encourage that kind of incentive for saving—for example, from the point of view of working women—we would be well advised to address the issue of pay inequity, and support the Fair Pay Act and the equal pay provisions, because women have far less disposable income to put into a savings plan, when the average woman is making less than $23,000, and when she is making 74 percent of her male counterpart, for African-American women the figure is 64 percent, and for Hispanic women the figure is 53 percent—53 cents compared to the dollar of her male counterpart. So for these women to plan for retirement is a particular burden when they are faced with the same pressures of inflation and family support but at a much lower level of compensation; we really need to address those overall issues because they're exacerbated when they get extrapolated over a career of lifetime earnings at a lower rate that is truly not equitable. That's what's making us the leader worldwide of elderly women living in poverty, for example.

Mrs. THURMAN. Madam Chairwoman, if I could just ask another real quick question here—Mr. Callahan, in your testimony, you talk about the unreasonable PBGC insurance premiums. This is all kind of new to me. So I'm just trying to learn this along with probably other people as well. You say that if they buy into this, that it's going to cost them a lot more. I was under the impression that there was a set premium per employee. Help me here.

Mr. CALLAHAN. There's a risk premium. There's a set premium per employee under the current rules of $19 per participant.

Mrs. THURMAN. Right.

Mr. CALLAHAN. But if a plan is under——

Mrs. THURMAN. Per year?

Mr. CALLAHAN. Per year. If a plan is underfunded, there's an additional risk premium, and that risk premium can vary significantly. So you can have very, very significant risk premiums if your plan is underfunded. So if they've promised benefits or if the assets perform poorly, if they promise benefits they haven't been funding, that additional amount can be significant.

If you establish a plan today and you want to grant credit past service, under existing rules, you're going to be underfunded for that past service that you've granted, and that's why you set the plan up today on a defined benefit basis. That's going to cause a risk premium; it's going to be a barrier for you to start such a plan.

Mrs. THURMAN. Can you give me an idea of how much we're talking about in this?

Mr. CALLAHAN. It could easily rise to $50 per participant.

Mrs. THURMAN. For a long period of time or just during the catchup period or——

Mr. CALLAHAN. It could be—a business lifetime is really 3 years. It's certainly going to be over a period of 3 years. It's usually been lasting somewhere in the neighborhood of 4, 5, or 6 years. It's continued to last. It doesn't go away.

As those plans become funded, as those plans reach new levels, and the interest rates go up a little bit, there will be a little bit of arbitrage there that will help us out, but the premium is going to be pretty substantial. You wouldn't want to establish a brandnew plan today with any past service grants. You'd really have to think about that an awful lot, because if you did that without having the ability to fund it on an ongoing basis, your PBGC premiums would be pretty substantial.

Mrs. THURMAN. Well, Madam Chairwoman, I've got to tell you, I'm probably going to walk away from this hearing today with more questions than I care to come with, I've got to tell you. So, hopefully, with your testimony rose a lot of other questions about some other things. If you get a chance, come by; I need to sit down and talk to you. [Laughter.]

Mrs. JOHNSON of Connecticut. Thank you. I'm going to recognize my colleague, Earl Pommeroy, who is one of the Congress' real experts on the pension issue, and we welcome him to sitting in on our Subcommittee, and we're happy to have him question. After that, we are going to recess. We have a vote on the journal and two 5-minute votes. So there will be about a 15-minute recess before we hear from Mr. Scanlon, our last witness.

Mr. POMEROY. Madam Chair, I thank you very much for allowing me to attend today and ask a question. I want to congratulate you for cosponsoring the SAFE legislation, being the driving force behind promoting its passage on the Hill, and thank you for holding this hearing.

Panel, this has been simply the best discussion about defined benefit plans in small employers that I have heard as a Member of Congress. I think that points out something. We really, as a Congress, haven't dealt in any way with the shift from defined benefit to defined contribution retirement plans, and the many consequences that it presents.

Mr. Moore, I would ask you, as spokesperson of the Pension Rights Center, for the worker, do you think there is still much to commend the defined benefit format, even though it is looking, especially in the small employer sector, like it's a dinosaur about to vanish from the face of the Earth?

Mr. MOORE. There is under the SAFE and some of the provisions of the SMART proposal, and some of the provisions that are being entertained on the Hill right now—I believe so. The ultimate thing that any employee is looking for is security, and that's something that the defined benefit plans provide par excellence.

It's also looking at employer contributions. If you don't have enough money to set aside for a plan, you know that someone is setting it aside for you, and that's a major plus of any sort of defined benefit plan, the employer contribution. So, yes, I believe that defined benefit plans have much to offer. I believe, particularly the way the SAFE and the SMART plans are, historically, the people who have been omitted are the small business employees, and this legislation targets them specifically. It gives them the opportunity to join in the benefits that some other people at larger corporations have. You look at the people who have some of the best pension benefits in this country. Their working at large employers, like GE or GEM, Monsanto, and now you're giving them the opportunity to get a crack at that, too. And I think it's excellent legislation, and I think it's a great opportunity for those people to enjoy the benefits of defined benefits.

Mr. POMEROY. Thank you, Mr. Moore.

I think Mr. Fradette, in particular—am I pronouncing your name correctly—is exhibit A in terms of what we're after, a small employer with personal retirement needs, but also recognizing the retirement needs of your small business work force, wanting to bring a defined benefit plan online, but not really able to under the existing lay of the land. In fact, we see that in employers under 20, defined benefit plans cover about 6 percent of the workers in that category. I represent the State of North Dakota, where most of the employers are in that category. So there's an awful lot of upside growth we can have there.

Does the SAFE design offer you something that you think would meet the needs of your agency?

Mr. FREDETTE. Yes, it does. I'm the pension amateur, if you will, the consumer here. But I do know what we need. No. 1, as a small business, we're in the business of staying in business, and right now unemployment is at an alltime low, which means that I want to hold onto the people I've got. They're very good people. We want to grow. We want to hire some new people. I want to be able to attract very good people, top-flight people. So I need a pension plan, and I've heard all kinds of names tossed out—SIMPLE, SMART, SAFE. I need a real plan——[Laughter.]

Mr. FRADETTE [continuing]. One that, No. 1, it's got to be affordable. No. 2, it's got to be flexible. I like that feature about being able to make up for lost time. And the acronym is fitting. It's got to be safe. I will sit here and promise you that I won't stick my hand in the employee pension cookie jar and I will make sure that I put the contribution into the cookie jar that I said I would. But that's just me. You've got to make it safe and reliable for all employees who are going to be counting on these retirement benefits.

Mr. POMEROY. Very well said. I look at the SMART proposal advanced by the administration as a conceptual endorsement of SAFE. They didn't get the details quite right, but in concept they identified the appropriateness of moving forward with an initiative to advance defined benefit plans in small employer settings. I think it's up to Congress to craft the details in the legislative process, and I would hope we do it much more along the lines of SAFE.

Let me move to a dimension of distinction between the two plans. The administration is concerned that we offer a fairly rich incentive to high-paid employees in these small employer settings, usually the owner. They're concerned that we bring along low-paid employees into the defined benefit process as well, not just have this be something that would be attractive to sole proprietors, for example, who would not really bring any employees into the defined benefit coverage other than the wealthy businessowner.

Mr. Callahan and Mr. Merolli—and this will be my final question—Mr. Leonard, do you have quick comments in terms of, will this sweep in, do you think, a number of employees to make it worthwhile?

Mr. CALLAHAN. The eligibility requirements state that you must earn $5,000 or more in 2 consecutive years, and be anticipated to have $5,000 or more the next year. This brings everybody in, including your part-time workers. A good number of part timers earn over $5,000.

So, certainly, the coverage requirements are met by bringing in all employees. No exclusions are allowed.

Second, the same level of benefits are being provided to the owners of the business as are provided to the rank and file. There are no differences; there are no permitted disparity that's allowed under existing rules. So even though as a percentage of pay, some of the rank and file may get larger retirement benefits because Social Security is slanted more toward those at a low-pay level, at ultimate retirement from the three-legged stool, the benefits that are provided from the employer and the incentive that we as a nation are providing to them are equal.

Mr. MEROLLI. Mr. Callahan basically took the words right out of my mouth. I was going to say essentially the same thing. Any employee who earns over $5,000 is covered, whether or not they're employed on the last day of the year. If someone leaves during the year, as long as they've earned $5,000, if the employer chooses to fund the plan for that year, and makes a 1, 2, or 3 percent, for example——

Mr. POMEROY. Based on your familiarity with the market, this will be of interest to more than just the sole proprietor or the person——

Mr. MEROLLI. Oh, yes, very, very much so. I think it will be of interest not only to the sole proprietor, but I think it would be of interest to the area that we haven't hit yet, the small business, OK, the tiny fraction of—there's only a tiny fraction of small businesses that have adopted plans, for that very reason, and I think this is the kind of thing we need because it makes it attractive to those businesses, to the over 80 percent of businesses under 25 lives that do not currently have a retirement plan.

Mrs. JOHNSON of Connecticut. We're down to about 3½ minutes now. I'm going to have to thank the panel for your help and your good comments throughout all of this, and we look forward to returning for our final witness. Thank you.

[Recess.]

Mrs. JOHNSON of Connecticut. I'd like to reconvene the hearing.

There are other colleagues that are particularly interested in your testimony, Mr. Scanlon. So I apologize for starting before they came, but I also have to leave. So when Mr. Kleczka gets here, we'll also kind of recap, or Mr. Coyne, but if we could start now, then we'll proceed when they get back, perhaps after you finish, go back and recap it. If you could start now, I'd appreciate it.

STATEMENT OF WILLIAM J. SCANLON, DIRECTOR, HEALTH FINANCING AND SYSTEMS ISSUES, HEALTH, EDUCATION, AND HUMAN SERVICES DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. SCANLON. That's fine, Madam Chairwoman. I recognize fully the many demands on your time. So I'm happy to start.

Mrs. JOHNSON of Connecticut. Well, I am very sorry that we had to slide the hearing 1 hour, and I don't know whether you heard my explanation, but I wouldn't have done it if there weren't good reason.

Mr. SCANLON. Right.

Mrs. JOHNSON of Connecticut. I appreciate——

Mr. SCANLON. I understand.

Mrs. JOHNSON of Connecticut [continuing]. Your cooperation in going so late in the evening.

Mr. SCANLON. OK. Well, thank you very much. I'm pleased to be here today, as you and the Subcommittee have discussed the financial concerns that face America's retirees. My remarks today rely very heavily on a report that we provided on early retiree health care coverage last July for Representative Kleczka.

[For additional information on the report referenced here, see *Retiree Health Insurance: Erosion in Employer-Based Health Benefits for Early Retirees*, GAO/HEHS–97–150, July 11, 1997.]

Mr. KLECZKA. Hello.

Mr. SCANLON. As I was mentioning, my remarks are very much drawn from the report that we prepared for you last July. While today's oversight hearing has highlighted the importance of expanding pension coverage so that retirees are not forced to live on their Social Security benefits alone, many workers face another serious predicament, the lack of affordable health insurance if they retire before they become eligible for Medicare at age 65.

As you're well aware, ERISA protects a worker's pension and health benefits, but only if the employer provides such fringe benefits. Thus, ERISA requires employers to fund their pension plans and gives workers vested rights upon meeting certain service requirements.

Health benefits, on the other hand, were excluded from the funding and vesting requirements. In fact, employers commonly finance health benefits both for active and retired workers on a pay-as-you-go basis. This arrangement leaves workers particularly vulnerable to economic or other circumstances that might prompt an employer to reconsider the terms under which health coverage is provided.

New accounting rules that became effective in 1993 and rapidly escalating health care costs are widely considered to have provoked such reassessments. If employer's have reserved the right to do so, nothing in Federal law prevents them from changing or eliminating retiree health coverage. In fact, an employer's freedom to make such changes is a defining characteristic of America's voluntary employer-based system of health insurance.

Slowly, but persistently, large American companies have decided to terminate retiree health insurance. According to Foster-Higgins, a benefit consulting firm, fewer than half of the companies with 500 or more employees offer health coverage to early retirees, and that number has declined from 46 percent in 1993 to 38 percent today. A similar decline has occurred at firms that offer coverage to Medicare-eligible retirees.

In addition to fewer employers offering retiree health benefits, a 1995 Labor Department study indicated that the likelihood of retirees enrolling in plans that are offered to them has also dropped because of the increased cost the companies are asking the retirees to shoulder.

The erosion in employer-based retiree health insurance is particularly troublesome to older Americans approaching or at retirement age. First, they consume medical services at a much higher rate, and their health care is commensurately more expensive than that of younger Americans.

Second, the alternatives to employer-based coverage are much more costly, at times to the point of being simply unaffordable, and not always available to everyone.

The 1997 implementation of the Health Insurance Portability and Accountability Act, HIPAA, eliminated one potential obstacle for retirees who lose group coverage through a former employer, but HIPAA did not address the affordability issue.

For eligible retirees, coverage can no longer be denied or restricted by a preexisting medical condition. HIPAA provides Federal standards to ensure that eligible individuals leaving employer-based group plans can purchase insurance on their own, if they can afford to do so. In most States, they will have access to the individual insurance market. However, because State laws governing the operation of individual markets differ, the premium faced by HIPAA-eligible early retirees varies considerably. Moreover, considering that large companies typically pay 70 to 80 percent of the premiums of workers, costs in the individual market may come as a rude awakening, since then is no one else to help share the expense for retirees.

Had HIPAA been in effect in 1996, when the Co. terminated health insurance for 750 retirees, those affected would have been guaranteed coverage. They would have faced, though, a standard premium of almost $8,200 per year for comparable family coverage in the individual market, provided they did not smoke. It would have been $11,000 a year if they did smoke—a cost they would then absorb on their own.

Premiums in other States can be higher or lower. Family coverage for a HIPAA-eligible early retiree would have been about $6,000 in Arizona, but nearly $12,000 in New Jersey. While New Jersey prevents carriers from increasing premiums due to health status, retirees in Arizona and Wisconsin both can be charged more than the standard premium if they had a preexisting health condition.

Early evidence from the implementation of HIPAA suggests that the rates developed by insurance carriers for the HIPAA-guaranteed products are substantially higher than the prices of standard products available in the individual market to those who are healthy. In addition, a number of States are using high-risk pools, which usually charge more than a standard policy premium, as the mechanism to guarantee coverage. As a result, these 1996 rates I quoted may understate the cost of HIPAA-guaranteed coverage available to persons in poor health in 1998.

The right to elect COBRA continuation coverage from a former employer is available to some, but not all retirees. COBRA allows covered individuals, upon retirement, to continue employer-based coverage for 18 months if their company does not offer health benefits to retirees. COBRA is not available, however, to retirees whose employer unexpectedly terminates their health care coverage at some point after retirement. To address that coverage gap for such retirees, bills have been proposed by Members of Congress, as well as the President, to allow retirees to purchase continuation coverage at a cost that reflects their higher utilization of services until they become eligible for Medicare.

In conclusion, let me note that the erosion in retiree health insurance has been persistent, despite an abatement, at least for the recent past, in health care inflation and the reemergence of a strong internationally competitive economy. This continued erosion raises a fundamental question about what protection will be available for retirees from employer-based insurance.

That concludes my statement. I'd be happy to answer any questions you have.

[The prepared statement follows:]

Statement of William J. Scanlon, Director, Health Financing and Systems Issues, Health, Education, and Human Services Division, U.S. General Accounting Office

Madam Chairman and Members of the Subcommittee:

We are pleased to be here today as you discuss issues related to pension benefits and retirement. As you know, forces in the U.S. labor market have been transforming the cash portion of retirement benefits, and these forces are impinging on retiree health benefits as well. Several factors suggest that retiree access to affordable health benefits is becoming an important national issue. These factors include the downward drift in employers' commitment to retiree coverage, the consideration of proposals to raise the Medicare eligibility age to 67, and the dramatic near-term increase in the number of retirees as millions of baby boomers approach retirement age.

You asked us to comment on the erosion in employer-based health benefits for retirees, especially early retirees who leave the workforce before age 65, when Americans typically become eligible for Medicare. My comments are based on a recent report we prepared at the request of Representative Jerry Kleczka.[1] His request was sparked by the Pabst Brewing Company's abrupt cancellation of health benefits for about 750 retirees of its Milwaukee plant in late 1996. My statement today will focus on three issues: (1) trends in access to employer-sponsored retiree health benefits, (2) the impact on retirees of an employer's decision to terminate health benefits, and (3) federal safeguards that protect the rights of retirees who have health benefits.

To address these questions, we reviewed surveys that track the availability of employer-based health coverage, data from health insurance carriers on the cost of alternative sources of coverage for individuals whose employers unexpectedly terminate retiree health benefits, applicable federal and state laws and legal precedents, and our earlier work. (See the list of related GAO products at the end of this statement.)

In summary, retiree access to and participation in private insurance through an employer has undergone a slow but persistent decline since the early 1990s. There are several explanations for this erosion in coverage. First, high and rising health care costs have spurred employers to look for ways to control their benefit expenditures, including eliminating retiree coverage and increasing cost sharing. According to the Labor Department, increased cost-sharing by retirees has contributed to fewer electing coverage when it is offered. Second, a new financial accounting standard developed in the late 1980s has changed employers' perceptions of retiree health benefits and may have acted as a catalyst for reductions in retiree coverage. The new rule makes employers much more aware of the future liability inherent in retiree health benefits by requiring them to account for its estimated value. By dropping retiree coverage, a company can immediately improve its balance sheet, making its stock more attractive to investors.

Losing access to employer-based coverage poses major challenges for retirees. The 1997 implementation of the Health Insurance Portability and Accountability Act of 1996 (HIPAA) has eliminated one potential obstacle for retirees who lose group coverage through their former employer—the possibility that coverage in the individual market will be denied or restricted by a preexisting medical condition. HIPAA provides federal standards to ensure that eligible individuals leaving employer-based group plans can purchase insurance on their own if they can afford to do so. Because state laws governing the operation of the individual market differ, however, the premiums faced by early retirees vary substantially. Moreover, considering that large companies typically pay 70 to 80 percent of the premium, costs in the individ-

[1] *Retiree Health Insurance: Erosion in Employer-Based Health Benefits for Early Retirees* (GAO/HEHS–97–150, July 11, 1997).

ual market may come as a rude awakening for early retirees. For example, had HIPAA been in effect in 1996, retirees trying to replace the benefits terminated by Pabst with comprehensive family coverage from a Wisconsin carrier would have faced an annual premium of almost $8,200—a cost that they would have had to absorb on their own. And, using 1996 rates again, family coverage for a HIPAA-eligible early retiree would have been $6,246 in Arizona but $11,825 in New Jersey. While New Jersey restricts carriers' premium-rating practices and generally requires all carriers to set the same rate for all plan participants in a community, eligible retirees in Arizona and Wisconsin can be charged much more than the standard premium if they have a preexisting health condition. Early evidence from the implementation of HIPAA suggests that rates developed by insurance carriers for HIPAA guaranteed access products are substantially higher than the prices of standard products available in the individual market to those who are healthy. As a result, these 1996 rates may understate the cost of a HIPAA product purchased in 1998.

A key characteristic of America's voluntary, employer-based system of health insurance is an employer's freedom to modify the conditions of coverage or to terminate benefits. When an employer has terminated retiree health benefits, federal courts have turned to the nature of the written agreements and other pertinent evidence covering the provision of retiree benefits to determine the legitimacy of the action. In essence, the issues before the court are often a matter of contract interpretation. If the employer explicitly reserved the right in plan documents to modify health benefits, the courts have generally upheld the termination of coverage. Individuals who are already retired when an employer terminates coverage are not eligible to temporarily continue that firm's health plan at their own expense.[2] COBRA coverage is only available to active employees who quit or retire or are fired or laid off. To address the potential gap in coverage when a former employer unexpectedly terminates health insurance, Members of the Congress as well as the President have proposed allowing affected retirees to purchase continuation coverage at a cost that reflects their higher utilization of services until they become eligible for Medicare.

BACKGROUND

Because of the cost, retiree health benefits are a concern to both employers and older Americans. Employers recognize that these benefits help to retain an experienced workforce but must also consider the cost of providing coverage. Older Americans approaching or at retirement age consume a higher level of medical services, and as a result, their health care is commensurately more expensive. For workers under age 65 and not yet eligible for Medicare, the decision to retire may turn on the continuation of health benefits by an employer. For those 65 or older living on a fixed income, employer-based benefits may help fill coverage gaps in Medicare, such as deductibles and copayments or the lack of a prescription drug benefit.

Overall, about one-third of retirees 55 and older received health benefits from a former employer in 1994. About 75 percent were over age 65, and any employer-based coverage available to them supplemented their Medicare benefits; the remaining 25 percent of retirees were generally ineligible for Medicare because they were between ages 55 and 65. For the latter group, employer-based benefits were the primary source of coverage.

Bureau of the Census data show that the number of retirees increased from 18.5 million to 23.4 million between 1988 and 1994. However, the first members of the baby boom generation are now aged 52 and poised to enter retirement, an event that will begin to dramatically increase the number of retirees.

DECLINE IN ACCESS TO AND PARTICIPATION IN EMPLOYER-BASED RETIREE COVERAGE

Data from an annual survey conducted by Foster Higgins, a benefit consulting firm, suggest a significant decline between 1988 and 1996 in the availability of retiree coverage from large employers with over 500 workers. Because of a change in the survey methodology, the pre-1993 data should not be viewed as authoritative.[3] However, the data from these two periods appear to be consistent. The data distin-

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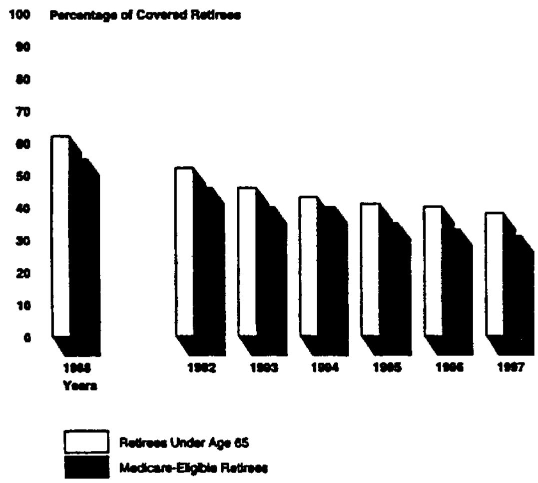
[2] Continuation coverage was mandated by the Consolidated Omnibus Budget Reconciliation Act of 1986 (COBRA), 29 U.S.C. 1161 et seq. For this reason, continuation coverage is known by the acronym COBRA.

[3] *National Survey of Employer Sponsored Health Plans 1996* (New York: Foster Higgins, 1997). Although the Foster Higgins survey dates from 1986, the survey methodology was changed in 1993 so that the results could be representative of all U.S. employers rather than just those who responded.

guish between early retirees and those who are Medicare-eligible. Since 1993, coverage for both groups has declined by 8 to 9 percentage points, a continuation of a trend evident since 1988. As shown by figure 1, early retirees are more likely than those who are Medicare-eligible to be offered health benefits by a former employer. In 1997, for example, only 31 percent of Medicare-eligible retirees were offered health benefits compared with 38 percent of early retirees.

Figure 1: Percentage of Large Employers Offering Retiree Medical Coverage, 1988 and 1992-97



Note: 1988 and 1992 data are not strictly comparable with data collected in 1993 and later. Large firms are those that employ more than 500 workers.

The two primary reasons cited for the decline in employer-based retiree health coverage are (1) new accounting standards, which highlight the magnitude of this liability over time, and (2) rapidly rising benefit costs. Since employers typically cover retiree health costs as they are incurred, the liability represented by a commitment to provide benefits to current and future retirees is largely unfunded. In 1990, the Financial Accounting Standards Board announced the introduction of a new rule, referred to as FAS 106, regarding these unfunded obligations. Beginning in 1993, employers were required to include the present value of future costs for retiree health benefits as a liability on their balance sheets. Many financial experts are concerned because these long-term liabilities erode equity positions and will become current obligations in future years.[4] The new standard does not require that employers set aside funds to pay for these future costs, and thus it does not affect their cash flow. However, by dropping retiree coverage, a company can immediately improve its balance sheet, making its stock more attractive to potential investors. In responding to benefit consultant surveys, many companies cited FAS 106 as a reason for modifying retiree health benefits, including the phasing out of such coverage.

The late 1980s was a period of double-digit health care inflation. Although the growth in premiums has slowed dramatically in the past few years, the percentage of large firms offering retiree health benefits has continued to drop. Among the reasons cited by Foster Higgins for the slowdown in the growth of employers' health

[4] For additional information on the impact of FAS 106, see *Retiree Health Plans: Health Benefits Not Secure Under Employer-Based System* (GAO/HRD–93–125, July 9, 1993).

care costs are that more workers moved into managed care plans—including retirees—and the fact that some employers dropped retiree coverage.

As shown in figure 1, employers are less likely to offer coverage to Medicare-eligible retirees than to early retirees. There are several potential explanations for this disparity. First, individuals are not as likely to seek early retirement if they cannot continue employer-based health benefits. A RAND study of the effect of access to postretirement health insurance found that the offer of continued coverage made it more likely that men aged 55 to 62 would retire.[5] Second, those who retired early through buyouts may have been guaranteed health benefits as an enticement to do so. Third, federally mandated COBRA coverage allows some individuals to retire at age 63–1/2 and continue with employer-based group coverage until they become Medicare-eligible at age 65. Finally, employers know that coverage is available to retirees aged 65 and older through Medicare, an option not open to younger retirees.

Coverage Influenced by Factors Other Than Availability

The decline in the number of large employers that offer retiree coverage is corroborated by an analysis conducted by the Labor Department's Pension and Welfare Benefits Administration. The study, which examined Current Population Survey (CPS) data, revealed a significant erosion between 1988 and 1994 in the number of individuals who retained employer-based health coverage upon retirement.[6] Only 42 percent of retirees aged 55 and older continued employer-based coverage into retirement in 1994, a decline of 8 percentage points since 1988. Moreover, the percentage of individuals with employer-based coverage continued to decrease throughout retirement. Thus, only 34 percent still retained coverage several years after retirement.

In addition to the availability of coverage, the Labor Department study suggests that cost is another factor contributing to the decline in retirees with employer-based insurance. Thus, the propensity for retirees to enroll in employer-based plans when they are offered has also dropped because of the increased costs retirees are being asked to shoulder by employers. In both the 1988 and 1994 surveys, individuals who declined employer-based coverage at retirement were asked the reasons for their decisions. Of the approximately 5.3 million retirees who discontinued employer-based benefits in 1994, an estimated 27 percent cited the expense as a factor—an increase from 21 percent in the earlier survey. Moreover, there was a 6-percentage-point increase over the same time period in the number of such retirees who indicated that they still had health insurance through a plan other than that of their former employer. Thus, some retirees who find coverage from their own employer too expensive may have switched to plans with lower cost-sharing available through a working or retired spouse.

Other sources of private insurance do appear to be filling a significant portion of the gap created by the fact that fewer employers offer retiree health benefits. We estimated that between 1989 and 1995, the percentage of early retirees with private coverage fell by only 7 percentage points, compared with a much larger drop in the number of employers offering retiree coverage.[7] If employer-based coverage is not available, early retirees may postpone retirement, purchase coverage themselves, or obtain insurance through a working spouse.

CPS data also contain insights on the characteristics of retirees more likely or less likely to have employer-based coverage. The characteristics for these two groups of retirees are summarized in table 1.

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[5] Lynn Karoly and Jeannette Rugowski, *The Effect of Access to Post-Retirement Health Insurance on the Decision to Retire Early*, RAND Reprints: 94–13E (Santa Monica, Calif.: RAND, 1995).

[6] U.S. Department of Labor, Pension and Welfare Benefits Administration, *Retirement Benefits of American Workers: New Findings From the September 1994 Current Population Survey* (Washington, D.C.: Department of Labor, Sept. 1995), p. 25.

[7] Our estimate is based on CPS data from the Bureau of the Census. See *Private Health Insurance: Continued Erosion of Coverage Linked to Cost Pressures* (GAO/HEHS–97–122, July 24, 1997).

Table 1: Characteristics of Retirees More and Less Likely to Have Employer-Based Health Benefits

MORE likely to have coverage	LESS likely to have coverage
Work for larger firms	Work for smaller firms
Have higher preretirement earnings	Have lower preretirement earnings
Belong to union	Are nonunion
Work in manufacturing or communications/public utilities	Work in retail sector or service industries
Work for public sector	Work for private sector
Are men	Are women
Are white	Are black or other race

Source: Department of Labor, Pension and Welfare Benefits Administration, analysis of CPS data.

EMPLOYERS' DECISIONS TO TERMINATE COVERAGE EXPOSE RETIREES TO NEW COSTS AND RISKS

If available, employer-based group health insurance provides two important advantages to retirees: (1) more affordable health benefits and (2) access to benefits for those retirees whose health status might otherwise impinge on their ability to obtain coverage in the individual insurance market. Such insurance is affordable because many employers continue to finance all or a significant amount of their retirees' health insurance premiums, even though over the last decade retirees have been required to pay an increasing share of these costs. In addition, the overall premiums for employer-based health plans are generally lower than those in the individual insurance market because the premiums that insurers charge employers are based on risks spread over an entire group of workers. In contrast, premiums in the individual insurance market reflect the risk characteristics of each applicant. These characteristics include not only age but also gender, health status, geographic differences in health care costs, and family size.[8] Unless there is a state law prohibiting price differences by age, most carriers charge higher premiums to older applicants.

Before the July 1, 1997, implementation of HIPAA, consumers, including retirees entering the individual insurance market, often discovered that they were not eligible for insurance or that their coverage was conditioned upon the permanent exclusion from the policy of an existing health problem. Many with specific health problems found coverage only at prohibitive prices. For example, health insurance carriers often declined coverage for acquired immunodeficiency syndrome (AIDS) and diabetes; offered coverage but excluded conditions such as asthma, ulcers, and glaucoma; and charged higher premiums for plans that covered problems like anemia and arteriosclerosis.[9] HIPAA guarantees access to the individual market by eligible individuals with qualifying coverage from a former employer—regardless of their health status—and also provides for the renewability of individual coverage.[10] This guaranteed access is often referred to as "portability." However, HIPAA offers no protection to Pabst retirees whose health benefits were terminated in 1996 or to any retiree who lost employer-based health benefits before its July 1, 1997, implementation date.[11]

Although HIPAA guarantees access to the individual market, it does not address the cost of coverage. Retirees no longer covered by their former employer's group health plan are likely to pay higher premiums for similar coverage in the individual insurance market. And with the loss of employer-based coverage, affected retirees who want to purchase health insurance must now absorb its full cost, which can be significant. Thus, had HIPAA been in effect in 1996, a Milwaukee retiree who

[8] For details on the individual health insurance market, including its structure, premium prices, the effect of demographic characteristics, and health plans offered, see *Private Health Insurance: Millions Relying on Individual Market Face Cost and Coverage Trade-Offs* (GAO/HEHS–97–8, Nov. 25, 1996).

[9] See GAO/HEHS–97–8, Nov. 25, 1996, for a discussion of the evaluation process that health insurance companies have used in providing access to the individual insurance market.

[10] HIPAA only guarantees access to the individual market to eligible individuals leaving group coverage. Thus, someone living in Arizona who wanted to purchase individual coverage but did not qualify under HIPAA could still be denied an individual policy because of a preexisting health condition.

[11] Wisconsin law requires insurers to accept individual applicants who previously had employer-based insurance if such insurance is not self-funded, but it does not apply to Pabst retirees because the firm self-funded its health benefits. Self-funded plans are those in which employers bear much of the financial risk for health claims. Employers that self-fund are not subject to state insurance regulation.

wanted to replace the benefits terminated by Pabst would have paid $8,187 for a standard family plan with a $250 deductible.[12] Since Wisconsin does not restrict the underwriting practices of carriers, a carrier may choose to charge an unhealthy individual more. Before its decision to terminate health benefits to retired employees at its Milwaukee plant, Pabst financed the total cost of practically all of the health plans it offered to retired workers. Given the substantial geographic variability of health insurance rates in the individual market, HIPAA-eligible retirees will be affected differently. For example, in 1996, a major carrier in New Jersey offered family coverage with a $250 deductible at an annual price of $11,825.[13] The price of similar family coverage in Maricopa County, Arizona, was only $6,264 in 1996. However, as in Wisconsin, HIPAA-eligible retirees in Arizona with preexisting conditions can be charged a premium much higher than the standard.

These 1996 rates may understate the actual cost of a HIPAA guaranteed access product purchased today. Thus, in September 1997 correspondence to the Chairman of the Senate Labor and Human Resources Committee on early HIPAA implementation concerns, we reported that (1) premiums for some HIPAA products may be substantially higher than for standard products available to healthy individuals and (2) the way many carriers will determine future premium rates for portability products may lead to even higher rates. Some carriers permit HIPAA eligibles to apply for both a HIPAA product and a lower-cost standard product. Since healthy individuals are likely to enroll in the less expensive option, only unhealthy individuals would be enrolled in the HIPAA product—a practice that could result in an increasing spiral of poorer risks and higher premiums.

States were allowed to choose a number of approaches to meet HIPAA's portability requirements. Thus, 22 states elected to use their high-risk pools to provide guaranteed access to the individual market for qualified individuals leaving group coverage. Prior to the enactment of HIPAA, many states had high-risk pools for those who had been denied coverage or had one of a number of specified health conditions. However, this safety net option often has very limited coverage and lower lifetime limits. The cost of a high-risk pool can be 50 percent more than the average or standard rate charged in the individual insurance market for a comparable plan. For example, the annual premium for a single male aged 50 to 55 in Wisconsin's high-risk pool averaged $5,122 in 1996—over $500 more than the cost in the individual insurance market. Wisconsin offers subsidies to families with incomes of less than $20,000.

Limited Federal Protection of Employer-Based Retiree Health Benefits

The Employee Retirement and Income Security Act (ERISA) protects both the pension and health benefits of workers. It does not, however, mandate that employers offer such benefits. ERISA requires employers to fund their pension plans and gives employees vested rights upon meeting certain service requirements; health benefits, on the other hand, were excluded from such funding and vesting requirements. In fact, employer-based health benefits for both active and retired workers are commonly funded on a pay-as-you-go basis.

Nothing in federal law prevents an employer from cutting or eliminating health benefits. In fact, an employer's freedom to modify the conditions of coverage or to terminate health coverage is a defining characteristic of America's voluntary, employer-based system of health insurance.[14] While ERISA protects the pension benefits of retired workers, it offers only limited federal safeguards to retirees participating in a firm's health benefit plan. ERISA requires companies to make a summary plan description (SPD) available to health plan participants within 90 days of enrolling. For retirees, the SPD that is in effect at the time of retirement is the controlling document. The SPD must clearly set out employee rights, including "information concerning the provisions of the plan which govern the circumstances

[12] Family coverage is for a retiree and spouse. The rate is for an individual who does not smoke. A retiree who smokes would pay about $11,000 for family coverage.

[13] This amount is for nonsmokers aged 55 to 59 with one child. Moreover, New Jersey restricts carriers' premium rating practices and generally requires all carriers to set the same rate for all plan participants within a community.

[14] The decline of traditional fee-for-service indemnity coverage and the growth in managed care enrollment exemplifies the ability of employers to modify their health benefit programs. Between 1987 and 1996, employer-based managed care enrollment rose from 27 percent to 74 percent as employers (1) altered the type and mix of health plans offered, sometimes eliminating the traditional fee-for-service indemnity option; (2) changed employee financial incentives; and (3) used the information provided to employees to influence their selection of health plans. See *Health Insurance: Management Strategies Used by Large Employers to Control Costs* (GAO/HEHS–97–71, May 6, 1997) for a discussion of the flexibility of large employers as well as the constraints they face in modifying their health benefit purchasing strategies.

under which the plan may be terminated." Employers must file these documents with the Department of Labor, the agency responsible for enforcing ERISA. According to Labor, unless employers have made a clear promise of specific health benefits for a definite period of time or for life and have not reserved the right to change those benefits, they are free to cut or terminate health care coverage.

Because federal law preempts state regulation of pension and health benefits, the rights of active and retired employees under ERISA are determined in federal courts. In reviewing cases involving changes to health benefit plans by employers, several federal courts have focused on the actual language used in plan documents and, if applicable, in collective bargaining agreements. Virtually all employers have reserved the right to modify health benefits for current and future retirees in such documents. However, if the language leaves some doubt as to the nature or duration of benefits, or if there are conflicts in the plan documents, the courts have examined significant written and oral representations made to employees to determine whether the employer has the right to modify retiree health benefits.

One ERISA protection—the right to elect COBRA coverage from a former employer if a worker is fired, laid off, or leaves a job—is available to some but not all retirees. Thus, COBRA allows covered individuals, upon retirement, to continue employer-based coverage for 18 months if their company does not offer health benefits to retirees.[15] Those eligible for COBRA coverage may have to pay the entire premium plus an additional 2 percent. For many individuals, the high cost of COBRA coverage is a shock because under employer-based coverage, large companies typically pay 70 to 80 percent of the premium. COBRA is not available, however, to retirees whose employer unexpectedly terminates their health care coverage at some point after retirement. To address the coverage gap for such retirees, Members of the Congress as well as the President have proposed allowing affected retirees to purchase continuation coverage at a cost that reflects their higher utilization of services until they become eligible for Medicare.

Madam Chairman, this concludes my statement. I will be happy to answer your questions.

RELATED GAO PRODUCTS

The Health Insurance Portability and Accountability Act of 1996: Early Implementation Concerns (GAO/HEHS–97–200R, Sept. 2, 1997).

Private Health Insurance: Continued Erosion in Coverage Linked to Cost Pressures (GAO/HEHS–97–122, July 24, 1997).

Retiree Health Insurance: Erosion in Employer-Based Health Benefits for Early Retirees (GAO/HEHS–97–150, July 11, 1997).

Health Insurance: Management Strategies Used by Large Employers to Control Costs (GAO/HEHS–97–71, May 6, 1997).

Private Health Insurance: Millions Relying on Individual Market Face Cost and Coverage Trade-Offs (GAO/HEHS–97–8, Nov. 25, 1996).

Employer-Based Health Plans: Issues, Trends, and Challenges Posed by ERISA (GAO/HEHS–95–167, July 25, 1995).

Retiree Health Plans: Health Benefits Not Secure Under Employer-Based System (GAO/HRD–93–125, July 9, 1993).

Mrs. JOHNSON of Connecticut. Thank you very much, Mr. Scanlon.

Are you aware of any information as to what it would cost retirees to be allowed to—early retirees—to be allowed to participate in COBRA? Are you familiar with any studies as to what the problems would be if we looked at that solution?

Mr. SCANLON. I don't have the specific information about what the differential might be for early retirees, the cost of care for early retirees versus other workers. However, it's something that we could look into for you and get you some of that information. Clearly, as older individuals, these people have higher expenses, and one

[15] COBRA only covers firms with 20 or more employees who offer health benefits to active workers.

of the questions might be as to how much you asked or allowed them to remain within the group and to enjoy the benefits of group coverage in a single——

Mrs. JOHNSON of Connecticut. For instance, if the employees of Pabst had been allowed to exercise COBRA rights, what would it have cost them as opposed to the $8,000? That is the figure?

Mr. SCANLON. Well, $8,000 was the——

Mrs. JOHNSON of Connecticut. Excuse me. The $8,000 was the individual market, correct?

Mr. SCANLON. The individual market, right.

Mrs. JOHNSON of Connecticut. And if they had been able to exercise a COBRA right, what would it have cost them?

Mr. SCANLON. It would have depended upon the premium for the Pabst coverage, which generally would be about half the level of the individual market. Now, again, there may be an issue of whether it's fair to the younger Pabst workers to allow the older retirees to receive coverage at the average premium, or whether or not there should be a surcharge for the fact that this is a more expensive population.

Mrs. JOHNSON of Connecticut. But, in general, it would be about half of the individual market, the COBRA part?

Mr. SCANLON. Right, but there's a lot of variation in both individual rates and group rates, but, very often it's about half.

Mrs. JOHNSON of Connecticut. And are you familiar with any studies that look at allowing Medicare eligibles to come back into Medicare, if their retiree plan expires or is terminated, and just pay the regular Medicare benefit?

Mr. SCANLON. No, I'm not.

Mrs. JOHNSON of Connecticut. Because, in a sense, the government hasn't been caring for them. So we have gotten a good deal, say, if they're covered the first 10 years of their retirement by their employers' plan. So to let them, then, sign up at whatever the average Medicare premium is at that time, or the appropriate Medicare premium at that time, seems to me a good deal for the government and a good deal for them.

Mr. SCANLON. I'm not aware of studies that have looked at companies that have maintained full coverage. I do know that many companies coordinate their benefits, so that as an individual becomes eligible for Medicare, they do enroll in the program, and then the employer's obligation will decline, and there may be quite a generous Medigap policy, basically, that one is getting from their employer.

Mrs. JOHNSON of Connecticut. Thank you.

Mr. Kleczka.

Mr. KLECZKA. Thank you, Madam Chair. First of all, let me thank the chairwoman for permitting GAO and Mr. Scanlon to appear before the Subcommittee today to share with us a report that was compiled at my request, and it was a report that had its roots in the Pabst situation, as Mr. Scanlon has pointed out.

I think what the report does indicate is a very, very disturbing trend in this country, wherein for this employee group we're seeing a rapid decline of employer sponsored health insurance. I think that has given rise to legislation not only introduced by myself, but clearly pushed by the administration, to provide some type of a vehicle for this segment of our society, be it an early retiree at age 55, whose company previously covered him or her, and then withdrew the coverage, like Pabst, or an employee who has been laid off permanently from his company; the company has closed, so that naturally would close off any COBRA option.

And the administration is proposing a buy in to the Medicare Program. For those 55 to 62, it would be a buy in at 100 percent of the cost. At 62 to 65, provided would be a premium with some subsidy, which would be recouped after age 65.

I think those two items by the President in his bill, and the third being comparable to mine, which is the buy in for COBRA, are just totally essential if we are going to provide some modus of coverage for this population within our society.

My question, Mr. Scanlon, would be as follows: Do you think the legislative proposals I just mentioned could be the impetus for employers to cancel employee health coverage and exacerbate the problem that we're seeing. The rationale the employer could use is, well, gosh, the government provides coverage; why should we? Do you see that as being one of the effects, if in fact Congress, in its wisdom, would move ahead on one of these proposals?

Mr. SCANLON. There may be some occurrence of that in what we do notice, in terms of how employers are providing retiree coverage today. There is greater generosity for early retirees than there is for retirees that are eligible for Medicare. And it's speculation, but one of the hypotheses that's suggested is that employers recognize that retirees under the age of 65 face very difficult insurance choices because of the portability issue, and that people over 65 don't. If there was public support for more affordable coverage for younger persons, maybe some employers would opt to do that.

How strongly that there would be that kind of a response is impossible to say.

Mr. KLECZKA. And, clearly the States that have gone into the risk premiums, like the State of Wisconsin, is clearly not the answer with average or little means. I think you pointed out the premium base for the State of Wisconsin for somebody who was in a risk pool; it's very, very expensive coverage. To think somebody who took early retirement, to think that that person might have the expendable resources to buy a $6,000 or $8,000 health plan is truly not the case. Those people eventually will go bare, will go without, and after one or two serious health care problems, they're going to be on the government program called Title 19 at some point, should they expend their assets to that level.

It seems to me that when we talk about retiree health care, for those employees in a bargaining unit that are represented, those benefits were not given to them by the grace of God or the generosity of the employer. Many of them gave up other benefits throughout their working years, be it pay increases or whatever, and it seems to me that for those situations we should expand the Pension Guarantee Corporation to provide some guarantee for those types of benefits also.

I asked the Director of the PBGC. He's going to get back to me, but have you any thoughts on that particular expansion of the current PBGC law?

Mr. SCANLON. Well, I heard your question earlier, and I think it triggered a number of thoughts. I thought as a potential early retiree that I would be very reassured by this kind of a guarantee. However, as an analyst, what I started to think about was exactly what this guarantee would provide, and how you would structure the health insurance benefit that employers would be offering and that their contribution to the PBGC would guarantee.

One of the difficulties that we have in the health care, and one of the things that has put pressure on employers, is the fact that we have been very poor at controlling inflation. So that with a guarantee over a long period of time, we run the risk that we haven't in some respects saved enough to be able to fulfill that guarantee.

So I think that the idea is intriguing. It may be most beneficial for some type of guaranteed coverage for early retirees, where you're talking about a fixed period of time, and it may also involve some switching from the concept of providing a defined benefit insurance plan, where you're guaranteeing people coverage to certain services, to a defined contribution, where you're going to empower them to be able to purchase insurance. But they may have to supplement it more if health inflation is so great that it outstrips the guarantee. In either case, they would be better off than they are currently.

Mr. KLECZKA. They surely would. We've seen a decline of 46 percent to 38 over a period of 5 years. Do you forecast or do you see that this decline is going to continue or have we leveled off, or where are we?

Mr. SCANLON. This is a relatively new phenomenon. So it's hard to be very confident that we are talking about a trend. What's disturbing about it is that we are seeing the decline continue even though we have a very, very strong economy right now, and even though we've brought health care costs sort of under control for the moment.

If you look back to the 1992–93 period, when the accounting standard changes were introduced, you saw a very dramatic drop, and you can very easily tie that to the accounting standards. Then you could also think about health inflation, and that sort of exacerbated the situation. If you ask yourself today, why is it continuing, the situation suggests that it may continue for the short term at least.

Mr. KLECZKA. Let's just return back to the health inflation. Has it not been retarded over the years? I know when we talked about the national health care bill in 1993, health care inflation was very moderate for that year and the next year. When the bill was moved off the front burner, we saw some moderate growth, but then we have the HMOs, health maintenance organizations, and the PPOs, preferred provider organizations, and the managed health care plans come in. What is the current health care inflation rate for, let's say, the last year?

Mr. SCANLON. I don't know the exact rate, but, basically, we have been very happy that we have one of the lowest rates that we've had in a very, very long time. We're starting to approach the point that health care inflation is almost equal to ordinary inflation, and as you know, ordinary inflation is relatively low these days. So we have succeeded. Since 1993–1994, we've seen a dramatic change and the rate of health inflation has gone way down.

Mr. KLECZKA. So health care costs can't be the culprit in these employers' denying. Definitely the accounting rule change was——

Mr. SCANLON. Right, right.

Mr. KLECZKA [continuing]. And we did look into that some time ago.

Mr. SCANLON. Right. And, historically, while costs may have been a culprit, they should be much less of a culprit today.

Mr. KLECZKA. But I think we're going to see this trend continue, as you estimate at this point.

Well, thank you very much for appearing, Mr. Scanlon. I think your report and your testimony indicate that there's a serious problem in this country for those retirees, early and at 55, and those retirees at age 62, when it comes to their health insurance cost. Medicare does not pick them up to 65 years old.

Last year there was a proposal in the Senate to expand or to lift that age requirement to 67, and it seems that what is going to happen to these people age 55 to, say, 65—there's a 10-year gap there, and if they're going to go out to the private market and start paying $6,000 to $8,000 per year for coverage, clearly, they're not going to survive. There have to be some other arrangements.

So I think your report, in my estimation, will help when the President's proposal comes up to expand the buy in to Medicare and/or my legislation, which would just expand COBRA.

So thank you very much for appearing today.

Mr. SCANLON Thank you.

Mr. KLECZKA [presiding]. Thank you.

Since I've been given the gavel, and I'm in the Minority party, we have other witnesses outside that we're going to call. [Laughter.]

CNN is coming with cameras. We've got a real show. [Laughter.]

But, seriously, that is all the business to come before the Subcommittee. The Subcommittee does now adjourn.

[Whereupon, at 6:01 p.m., the hearing was adjourned, subject to the call of the Chair.]

[Submissions for the record follow:]

Statement of Hon. Roy Blunt, a Representative in Congress from the State of Missouri

As a member concerned with retirement income security, I am filing this statement to compliment the subcommittee on its long standing interest in this issue and to suggest a proposal for your consideration.

Although ERISA was enacted to enhance retirement benefit security, current data suggests that it is not working for all Americans. Indeed, as the Treasury Department recently reported, over half of all American workers lack coverage by a private pension plan. That gap is not evenly distributed among all employees, but is concentrated among those who work for small employers. Only 20 percent of workers in firms with fewer than 100 employees have pension coverage.

Recent efforts, including the SIMPLE plan adopted in 1996 and the SMART plan and payroll deduction IRAs included in the President's FY 99 Budget proposal, approach this problem with design-based retirement plans that provide guaranteed minimum benefits for all employees who meet certain minimum service requirements. To encourage adoption, these arrangements are exempt from certain of the most burdensome administrative requirements. However, benefits provided under these arrangements are very limited (annual employee contributions under the SIMPLE plan are limited to $6,000 with matching contributions capped at 3% of the employee's compensation, and annual benefit accruals under the SMART plan would be limited). Thus, we currently maintain a two tier system, comprised of:

• qualified plans which are permitted to provide significant retirement benefits (i.e., annual contributions of up to $30,000 under a defined contribution arrangement, and annual benefits of up to $125,000 (for 1998) payable under a defined benefit pension plan), but are subject to the full range of tax qualification requirements and ERISA reporting and disclosure rules; and

• special, design-based plans for certain small employers under which reduced administrative burdens buy significantly reduced benefit opportunities.

Similarly, the SAFE proposal, developed by Chairman Johnson and members of the subcommittee is a defined benefit plan that would limit benefit accruals to a maximum of 3% of compensation, and would require the plan to be funded with annuities.

Additional Relief is Needed

Unfortunately, these are often not viable options for the small employer who is willing to provide more generous benefits for its employees if plan costs consist primarily of funding benefits instead of unnecessary administrative expenses. Thus, while I support enactment of a payroll deduction IRA and a simplified defined benefit plan, I have been working with others to develop a hybrid approach, applicable to small employers.

As described below, the bill I plan to introduce will, effective for years after enactment, create a new design-based plan permitting eligible small employers who agree to provide significant benefits to all employees to sponsor a hybrid defined contribution plan providing full benefits; provide a uniform definition of eligible small employers; simplify the eligibility requirements applicable to all small employer plans; repeal the "top heavy" rules; permit plans to use a uniform definition of compensation for purposes of plan qualification and calculating permitted deductions; simplify annual reporting requirements; and provide a tax credit for certain start-up expenses. Each of these provisions is discussed below in detail.

Design-Based Plan

My bill creates a new, simplified design-based plan for small employers. Unlike prior simplified plans (e.g., SEPs, SARSEPS, SIMPLE and the proposed SMART plan) this proposal would permit small employers to provide the same level of benefits permitted under qualified defined contribution plans (i.e., annual contributions equal to the lesser of a specified dollar amount ($30,000 for 1998) or 25 percent of compensation) to their employees.

In exchange for the employer's agreement to provide 100 percent coverage, accelerated vesting, minimum non-integrated benefits, and to accept limitations on investments in employer securities, the eligible small employer would be permitted to provide these benefits under a single plan that combines the features of a present law money purchase pension plan and a discretionary contribution plan, thereby eliminating the need to adopt two plans with duplicate set-up, administration and compliance costs. The small employer retirement plan I propose will be treated as a new discretionary contribution plan that is not a profit-sharing, stock bonus or money purchase pension plan.

Small Employer Defined to Include Employers with 100 or Fewer Employees

My proposal incorporates the most commonly accepted definition (used for purposes of the SIMPLE plan, the Administration's FY 99 Budget proposals for SMART plans and the proposed tax credit for plan start up costs) of a "small employer" as one with 100 or fewer employees. Administration data suggests that it is appropriate to target such employers because only 20 percent of employees in such firms currently participate in employer-sponsored retirement plans.

The Administration's proposed SMART plan would not be available to a small employer that is also a "professional service organization" which would include organizations dedicated to health, law, engineering, architecture, accounting, actuarial services, performing arts or consulting. Given that the majority of employers with fewer than 100 employees fall into one of these categories, excluding such employers from utilizing the simplified plans would exclude from plan coverage a large percentage of the employees targeted for coverage. Accordingly, my proposal will not include such restrictions.

ELIGIBILITY SAFE HARBOR

Under my proposal, small employers who are willing to provide benefits for all employees who meet statutory minimum age and service requirements (thereby surrendering their flexibility to arbitrarily exclude 30 percent of such employees), would come under a safe harbor permitting (i) use of a single eligibility computation period—the plan year; and (ii) a single annual entry date—as of the first day of the plan year following the plan year in which the age and service requirements are satisfied.

REPEAL THE "TOP HEAVY" RULES

In order to maintain qualified status, all retirement plans must satisfy certain requirements designed to ensure that the plan provides meaningful benefits to a nondiscriminatory group of employees. In addition, under current law, all qualified plans must comply in form and operation with special "top-heavy" rules designed to protect non-key employees. Under these rules, a top-heavy plan must, among other things, implement accelerated vesting schedules and provide minimum benefits for non-key employees,.

Since the top heavy rules were enacted in 1982, numerous changes have been made to plan qualification rules that render these restrictions virtually meaningless. For example, the Tax Reform Act of 1986 made substantial revisions to the nondiscrimination and Social Security integration rules, expanded the limit on pensionable compensation and accelerated vesting schedules for all plans (although not to the extent required for top heavy plans). The Small Business Jobs Protection Act repealed, effective for years after 2000, the combined plan limit applicable to all plans, including the restricted limit applicable to certain top heavy plans. And, the Administration's FY 99 Budget proposals would further accelerate vesting by applying the top heavy plan vesting schedules to all employer matching contributions made under 401(k) plans. I believe these broader changes make the special top-heavy plan rules obsolete, which is why I propose to repeal these rules.

UNIFORM DEFINITION OF COMPENSATION

Under present law, tax-qualified retirement plans must use "gross compensation" (i.e., taxable compensation plus pre-tax salary deferrals) to determine whether the plan satisfies limitations on benefits and contributions and whether an employee's elective deferrals meet nondiscrimination rules. However, they must use "net compensation" (i.e., taxable compensation less the amount of any pre-tax salary deferrals) to determine the deductibility of employer contributions to the plan. Because of the administrative costs associated with having different definitions of compensation for different purposes, my proposal would establish the use of "gross compensation" for all purposes.

SIMPLIFIED 5500 FILING REQUIREMENTS FOR SMALL EMPLOYERS

Although efforts have been made to reduce unnecessary administrative burdens on small employers, (e.g. TRA 97 made it unnecessary to file Summary Plan Descriptions and Summaries of Material Modifications with the Department of Labor, and the FY 99 Budget Proposal would, at least for SMART plan sponsors, provide unspecified relief from burdensome filing requirements) more needs to be done. The breadth of relief must be expanded to apply, not only to SMART plan sponsors, but to all small employers that use standard documents. Specifically, I recommend that:

• plans in which the only participant is the employer (or the employer and spouse), that have at the end of the plan year plan assets of $500,000 (as opposed to $100,000) or less be exempt from filing Form 5500; and

• businesses with fewer than 25 employees on the first day of the plan year be permitted to file a form 5500EZ, even if additional employees are hired during the year, and regardless of the value of the plan assets.

TAX CREDIT FOR CERTAIN PLAN START-UPS

Finally, it is a fact that regardless of what simplification measures are enacted, implementing a new retirement plan necessarily involves certain start-up costs. In recognition of this fact, the Administration's FY 99 Budget Proposal, effective beginning in the year of enactment, would provide a new tax credit for small employers who adopt a SIMPLE, a SMART, any other tax-qualified plan or salary deduction IRA on or before December 31, 2000. Applicable to small employers that did not maintain any retirement plan or payroll deduction IRA in 1997, the credit would be equal to 50 percent of the administrative and retirement education expenses incurred in establishing the plan, capped at $2,000 for the first year, and $1,000 for the next two years. While I applaud this effort, I believe further relief is appropriate. Accordingly, I recommend that the credit be extended to cover at least the first five years of plan operation.

CONCLUSION

I hope as you move forward with pension reform you will take seriously the proposals I have advanced and include the hybrid plan described above in your recommendations.

Statement of Paul J. Yakoboski, Ph.D., Employee Benefit Research Institute [1]

INTRODUCTION

As of 1993, the latest year for which nationally representative data are available, 64 percent of all civilian nonagricultural wage and salary workers worked for an employer that sponsored a retirement plan, and 49 percent of all workers participated in a retirement plan sponsored by their employer.[2] Probably the most notable gap in employment-based retirement plan coverage is among small employers. While 85 percent of workers at employers with 100 or more employees have an employer that sponsors a plan, only 50 percent of workers at employers with 25 to 99 workers, and 20 percent of workers at employers with fewer than 25 employees have an employer that sponsors a plan. The findings regarding participation are similar. Two-thirds of workers at employers with 100 or more employees actually participate in an employment-based retirement plan, compared with 36 percent of workers at employers with 25 to 99 workers and 15 percent of those at employers with fewer than 25 workers.

WHY THE GAP?

Why do sponsorship rates and participation rates lag so much among small employers? EBRI first examined this issue 10 years ago in a book entitled Pension Policy and Small Employers: At What Price Coverage? Chief among the reasons highlighted as to why small employers do not sponsor a retirement plan were financial cost/lack of affordability and the burden of administering a plan, with the latter often contributing to the former. Other factors cited were the lack of need for a plan and a preference among employees for cash compensation. Many employers noted that they had a high turnover work force and therefore their employees would not be interested in a plan with vesting requirements. They also felt that retirement income was at best a remote goal for the young workers who often make up their work force. Finally, small employers expressed a preference to reward performance selectively by paying bonuses. What developments would lead small employers to start a plan? The same research indicated that improved business profitability, increased tax advantages, and increased employee demand may lead small employers without a plan to start one.

Coverage rates have remained basically unchanged among small employers over time. A list of likely reasons for not having a plan would look pretty much the same: cost/administrative burden, low/uncertain profits, and lack of demand on the part of workers at small employers would likely lead the list. However, because of a lack of recent research in this area, EBRI, ASEC, and Mathew Greenwald and Associates have expanded the 1998 Retirement Confidence Survey project to include a survey of small businesses, both those with a retirement plan and those without one. The survey will explore the reasons that small employers do not offer a retirement plan and the changes that would lead them to consider doing so. Among small employers that do offer a retirement plan, the survey will explore the types of plans they offer and their motivations in offering these plans. Results should become available in May, and EBRI would be happy to share them with the committee when available.

[1] The views Expressed in this statement are solely those of the author and should not be attributed to the Employee Benefit Research Institute, or the EBRI Education and Research Fund, its officers, trustees, sponsors, or other staff, or to the EBRI–ERF American Savings Education Council. The Employee Benefit Research Institute is a nonprofit, nonpartisan, public policy research organization which does not lobby or take positions on legislative proposals.

[2] These figures are Employee Benefit Research Institute tabulations of the 1993 Current Population Survey employee benefits supplement.

Recent Developments

The Small Business Job Protection Act of 1996 created a simplified retirement plan for small business called the savings incentive match plan for employees (SIMPLE). SIMPLE plans can be adopted by employers who employ 100 or fewer employees on any day during the year and who do not maintain another employment-based retirement plan.

A SIMPLE plan can be either an individual retirement account (IRA) for each employee or part of a 401(k) plan. If established in IRA form, a SIMPLE plan is not subject to the nondiscrimination rules generally applicable to qualified plans (including the top-heavy rules), and simplified reporting requirements apply. Within limits, contributions to a SIMPLE plan are not taxable until withdrawn.

A SIMPLE plan can also be adopted as part of a 401(k) plan. In that case, the plan does not have to satisfy the special nondiscrimination tests applicable to 401(k) plans and is not subject to the top-heavy rules. The other qualified plan rules continue to apply.

Small employers have established SIMPLE plans in greater numbers than most in the retirement community anticipated. Although no nationally representative data are yet available, a non-random survey by the Investment Company Institute (ICI) of its members[3] indicates that plan establishment has been concentrated among employers with under 10 employees and that the SIMPLE–IRA is preferred over the SIMPLE-401(k). More specifically, the survey found that 18,261 SIMPLE IRA plans, with 95,431 participants, had been established, and 42 SIMPLE 401(k) plans, with 785 participants, had been established.[4] Eighty-seven percent of SIMPLE plans were established by employers with 10 or fewer employees, and 97 percent of employers establishing a SIMPLE plan had 25 or fewer employees.[5]

Congress is now considering proposals by the Clinton Administration and others to create a "simple" version of a defined benefit plan for small employers. Creation of such a plan would mean that small employers interested in establishing a retirement plan via the "simple" route would no longer be restricted to choosing a defined contribution plan. Other proposals being considered to promote retirement plan coverage among small employers include a tax credit for businesses establishing a new plan.

Conclusion

As Congress considers various proposals to promote retirement plan coverage among small employers, expectations should be kept realistic. Coverage rates among small employers are unlikely ever to approach those of large employers simply because of the financial reality of small and uncertain profits faced by many small businesses, combined with what is currently a weak interest in contributing to a retirement plan among many young and low-earning workers. These realities mean that is not enough simply to target the small employer, but it is also important to target employees with messages regarding the need to plan and save for their retirement.

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[3] Survey results were based on responses from 26 firms, including two-thirds of the largest 25 mutual fund firms. The survey objective was to quantify the number of SIMPLE plans and accounts that were established between January 1 and July 31, 1997, among members of ICI's pension committee.

[4] Given the limited nature of the sample, these figures likely undercount significantly the total number of SIMPLE plans established during this time period

[5] The survey used "accounts established per employer plan" as a proxy for employer size, which likely understates the average size of each employer to some degree.