PENSION ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

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PENSION ISSUES

TUESDAY, MARCH 23, 1999

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

The subcommittee met, pursuant to notice, at 3:00 p.m., in room B–318, Rayburn House Office Building, Hon. Amo Houghton (chairman of the subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–7601
March 16, 1999
No. OV–4

Houghton Announces Hearing on Pension Issues

Congressman Amo Houghton (R–NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on pension issues. The hearing will take place on Tuesday, March 23, 1999, in room B–318 Rayburn House Office Building, beginning at 3:00 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 U.S. Department of the Treasury, the Pension Benefit Guarantee Corporation, and representatives from organizations knowledgeable about pension issues. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The importance of the private pension system stems from its role in the traditional model of retirement income security, often visualized as a three-legged stool, supported by Social Security, employer-sponsored retirement plans, and personal savings. For example, in 1993, 67 million workers (57 percent of all workers) worked for an employer that sponsored a retirement plan, but at the same time, over 50 million workers did not participate in a retirement plan.

The Federal Government historically has sought to encourage the growth of private pension plans by providing favorable tax treatment to them. As early as 1921, the tax law exempted from taxation the interest earned by profit-sharing pension plans. Since then, the tax law has evolved into a complex array of provisions designed both to encourage employers to establish private retirement plans, as well as to influence their contents and features. The structure of the current pension tax law attempts to balance competing objectives. The policy of encouraging the establishment of pension plans often is tempered by provisions to limit plan designs that might unduly benefit a few highly-paid employee.

The cumulative effect of including numerous policy objectives in the pension tax law has been to make it more complex. The pension tax law places limits on contribution amounts, benefits levels, and funding amounts. It imposes special rules for treating "key" employees earning $65,000 or more annually, as well as "highly compensated employees" earning $80,000 or more annually. The tax law also imposes requirements regarding pension plan coverage and nondiscrimination rules. The nondiscrimination rules apply a set of mechanical rules to curb the operation of a plan which might otherwise unduly benefit a small number of well-paid executives.

In announcing the hearing, Chairman Houghton stated: "The private pension system is the cornerstone of a secure retirement for most people. Congress should explore how it can improve the features of existing pension plans as well as encourage more employers to sponsor retirement plans for their employees. The objective is to make a good pension system even better by having more workers participating in retirement plans with even better features."

FOCUS OF THE HEARING:

The Subcommittee will examine employer coverage and employee participation issues, particularly for low-income and part-time workers, women and others who may not be adequately served by current law. The Subcommittee will also explore ways to remove burdensome regulatory requirements, improve the level of benefits that workers may accrue towards their retirement, and improve the portability of pension benefits by removing artificial barriers which prevent workers from rolling over their benefits among pension plans.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the *close of business*, Tuesday, April 6, 1999, 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, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

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

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

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

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

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

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

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

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

Chairman HOUGHTON. The hearing will come to order. Thank you very much.

Good afternoon, ladies and gentleman, and welcome to our hearing to explore current pension issues.

The private pension system, to give you a little bit of background, is the cornerstone of retirement security for most working Americans. The private pensions, along with social security and personal savings, are the three traditional components of a person's retirement income. And we can improve the standard of living for our retirees by strengthening that private pension system.

Congress recognized the desirability of promoting private pensions as early as 1921, when it enacted favorable tax treatment for the interest income of pension plans. Since then, Congress has expanded, reformed, refined, amended, and tinkered with pension tax law numerous times. Some changes were meant to expand coverage. Some changes were meant to curb the possible abuse of pension rules. Finally, some changes were meant to influence the content and features of pension plans. Recent changes were meant to raise revenue as part of some omnibus deficit reduction budget Act.

While each of the separate changes made over the years had a legitimate purpose, the cumulative effect has been to make the pension law overly complex. The real harm, of course, which complexity causes is that employers may shy away from establishing pension plans. In such cases, the real losers are employees of the business owner who decides not to establish a qualified retirement system.

Last year, this subcommittee held two hearings which explored how best to achieve several pension objectives. First, how to simplify the pension law. Second, how to encourage employers to establish pension plans for their workers. Third, how to improve the level of income security for participants in pension plans. And, fourth, how to address the special needs of caregivers who often are women, whose work history may have several major breaks in their service.

So today the subcommittee will continue the pension plan oversight which it began last year. There are numerous ways to achieve our pension objectives. Our colleagues Robert Portman, who sits to my right, and Ben Cardin—well, I'm not sure he's here yet—have introduced H.R. 1102, the Comprehensive Retirement, Security, and Pension Reform Act. And our colleague Richard Neal, who is sitting over here to my left, has introduced H.R. 1213, which includes a number of the administration's proposals. So I hope that today's hearing will improve our understanding of the issues and help lay the groundwork for further progress in the 106th Congress.

I look forward to hearing the testimony of today's witnesses and I would like to recognize Mr. Coyne, the ranking Democrat on the committee.

Mr. COYNE. Thank you, Mr. Chairman. Today the Oversight Subcommittee is going to focus on one of the most critical issues facing American workers and their families: pension coverage and saving for the future. Retirement income is a concern to all Americans, whether they are currently retired, planning for retirement, or worrying about the economic stability of their retired parents and grandparents.

As the Ways and Means Committee discusses Social Security reform in a broader sense, we should not lose sight of the larger retirement security picture, which includes pensions and retirement savings. Some of the recent proposals to create individual investment accounts may be most appropriately considered in the context of our pension system rather than the Social Security reform effort.

About half of all American workers—about 50 million people in all—are without pension coverage. When many of these workers retire, they and their spouses will have to depend on modest Social Security payments, their personal savings, and the generosity of friends and family just to get by.

In the district that I represent, 43 percent of the people who are retired are pensionless, except for Social Security. Social Security checks, which average less than $750 a month in Pennsylvania, are all many of them have to live on.

As we think about retirement income and Social Security reform, we must remember that three-fourths of the elderly poor are women. One of the primary reasons for the disproportionate share and the number of elderly women in poverty is their disproportionate lack of private pension coverage. Women tend to move in and out of the work force more than men, work at home more, and earn less for the work that they do. All of these factors make them more likely than men to have very small pensions or none at all. This gap does not appear to be going away as more women are working and studies have shown that, even when factors like education and profession are taken into account, women are less likely to have significant pensions.

The Teresa and John Heinz Foundation has been a leader in calling attention to the plight of women and other groups of pensionless workers and in promoting retirement savings within this population group. This is just one of the many philanthropic initiatives that the Heinz Foundation has undertaken. The Foundation's endeavors benefit both the Commonwealth of Pennsylvania and the Nation as a whole. Accordingly, I am particularly pleased that Teresa Heinz will be testifying at the hearing today.

Today we will also discuss various proposals and approaches to expanding pension coverage and simplifying our pension and related tax rules. It is my hope that the testimony and views of the Treasury Department will provide us with some historical perspective on our current laws, tax-related pension rules, as well as the administration's position on various proposals for reform. And, as the chairman has pointed out, our colleagues, Congressmen Neal, Portman, and Cardin, have proposals before the committee and I look forward to hearing more about them.

I thank Chairman Houghton for holding this hearing and I want to recognize his long-standing commitment to adopting pension policy changes that will help the average worker secure a safe retirement. Thank you.

Chairman HOUGHTON. Thanks very much, Mr. Coyne. Mr. Portman, would you like to deliver an opening statement?

Mr. PORTMAN. I thank the Chairman. I will be brief. First, I thank you very much for holding this very important hearing and for the witnesses that we have before us today, thank you. I am looking forward to hearing from all three panels.

We find ourselves in a retirement squeeze and it is because people are living longer, saving less, and we have 76 million baby boomers starting to retire in only 10 short years. And it is very important that we prepare for that. Neither the private nor public system are ready for it. We must, as Mr. Coyne said, focus on Social Security, the fiscal problems. We will. Another subcommittee of this committee is working on this. And it is very important for the President and the Congress to roll up their sleeves and do that.

But we also have to remember that Social Security was never intended to meet all the financial needs of retirement and, for most Americans it does not. Rather, along with private savings and pensions, the three legs that Mr. Houghton talked about in his statement, we support Americans in their retirement years. And all is not well with the pension leg. Mr. Coyne talked about the fact that only half of workers have a pension plan. That is a tragedy. That is something we need to focus on in this subcommittee and with our work. That means that about 60 million Americans don't have access to one of the key components to retirement. And for small businesses this is far worse, of course. Only 19 percent of small businesses, those with under 25 employees, offer any kind of pension retirement plan at all.

The personal savings rate in our country, as we know, is at its lowest rate in years—since 1933. In fact, we now believe that baby boomers, as a rule, only have about 40 percent of the savings they will need for a comfortable retirement.

It is for all these reasons that we introduced, Mr. Chairman, H.R. 1102. Ben Cardin, I think, has joined us now. He is my cosponsor on H.R. 1102. We have also got an influential and dynamic bipartisan team with us, including Chairman Houghton, significantly. But it is a group of members who have been involved in pensions over the years and we have kept this bipartisan from the start and intend to continue to do so.

The bill does knock down the barriers you talked about to try to simplify our laws. It raises the limits to let people set aside more of their earnings, and creates new incentives for small businesses which we are going to talk about today. It has a special catch-up provision to help workers for the years they spent outside of the work place, especially I think appropriate for those who have been working moms and returning to the work force after raising their children.

We also get into the new realities of the mobile work force with portability, with faster vesting. We believe that people are changing jobs more and more. That isn't going to change. And we need to create laws that respond to that reality. We believe that just because you change your job, that doesn't mean that you lose your pension.

If enacted, all these changes together—and there are many of them—will expand savings. They will make a significant difference for people in their retirement. It will be the difference between retirement subsistence or retirement security for millions of Americans. So, again, I thank you very much, Mr. Chairman, for expediting this process of having a hearing. I know you have a lot of things on your plate and the importance you attach to it is much appreciated. I look forward to the hearing.

Chairman HOUGHTON. I thank you very much, Mr. Portman. Mr. Neal, would you like to say something? And then Mr. Cardin, I would like to call on you for just a brief word. But, please, Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. I don't think that one can improve upon what has already been stated. We have all done, I think, a pretty good job of defining the nature of the problem. But I do have a brief statement that I would like to read and then request that the official statement be inserted into the record.

Mr. Chairman, as you know, yesterday I introduced H.R. 1213, the administration's pension proposals. Incidentally, last year I thought we had a good chance of enacting something working with Mrs. Johnson, but the clock simply ran out on us at the end. I very much appreciate your willingness to have this hearing on pension issues generally. I know that President Clinton and the administration has worked particularly hard to improve the current system and we should compliment them on this occasion.

In addition, a number of our colleagues, most especially Mr. Portman and Mr. Cardin, have also worked very hard in this area to try to improve the current pension system. I believe we should seize every opportunity to accomplish this. And while the 106th Congress is expected to address the problems of the Social Security system, I think it is imperative that this Congress expand and improve the private pension system as well.

I think the witnesses today can shed some light on the nature of the problem and I think, once again, that we all have a pretty good understanding of how far reaching it is. It is our obligation, I think, in this Congress to see if we can't achieve something that's tangible, and, just as importantly, very meaningful. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you, Mr. Neal. Mr. Cardin.

Mr. CARDIN. Well, Mr. Chairman, first, thank you very much for holding this hearing. It looks like we need to get a larger hearing room. But we very much appreciate the early hearing on pension issues. I want to just reiterate what Mr. Portman has said. The two of us have worked together in a bipartisan way to try to do something about private pensions and retirement savings in this country.

Regardless of what we do on Social Security, we need to increase private retirement savings in this Nation. Although our economy is going very well, almost all indicators—if you take a look at unemployment; take a look at what has happened with the deficit and projected surpluses; the interest rates are low—but savings rates are entirely too low and we need to do something about it. The legislation that we have put forward basically makes it easier for individuals and companies to put money away for people's retirement; to make it easier to deal with the realities of the current work force where people might work for two, three, four, five employers during their lifetime; to allow people to be able to put more money away for their personal retirement.

We eliminate some of the complicated rules that really serve very little purpose today. As Mr. Portman said, there are literally dozens of revisions in H.R. 1102 that we encourage our colleagues to take a look at. Working with the administration, working with this committee, we hope we will be able to make progress on pension reform in this Congress. I thank you for the courtesy of allowing me to sit in on the hearing. I serve on the full committee, but not the subcommittee and I would ask that my full statement be put into the record.

[The opening statement follows:]

Opening Statement of Hon. Benjamin Cardin, a Representative in Congress from the State of Maryland

Mr. Chairman, I want to congratulate you for holding this hearing on the vital issue of reforming our nation's pension laws.

Over the past three years, concerned members of Congress, working closely with the Clinton Administration, have accomplished an important turn-around in federal policy on retirement savings. Through the 1980's and the first half of this decade, changes in federal pension law made it more difficult for Americans to save for retirement. While the rhetoric of policy-makers recognized the importance of increasing the nation's savings rate, their actions imposed new and more burdensome limitations on Americans seeking to do so.

The approaching retirement of the baby boom generation has increased public and congressional awareness of the crisis in Social Security, and the need to take strong action to assure the future solvency of the program. I am committed to keeping the promise of Social Security to current and future retirees, and I look forward to working with the members of this committee toward that goal.

At the same time, we must recognize that Social Security can only provide a supplemental level of retirement income. It was not designed as a full retirement income program, and will not become one under any reform proposal.

That is why we must devote our attention to our private pension and retirement savings system. We need to to continue to more in the new direction we have taken in the past few years of removing cumbersome and unneeded restrictions on private pension plans. Last week, Rep. Portman and I introduced H.R. 1102, the Comprehensive Retirement Security and Pension Reform Act of 1999. This bill, which has strong bipartisan support, is designed to match the rhetoric of increasing savings opportunities with the reality of legislative proposals.

The goal of the bill is to make it easier for Americans to save through employer-provided retirement plans. We want to extend the opportunity to save to more Americans, and to allow them to save more. The bill recognizes the fact that for most Americans, the best opportunity to save comes through an employer-sponsored plan.

Fifteen years of changing the law to make it more difficult to save has contributed to a reduced rate of personal savings. In developing the bill, we started with the idea that savings will increase if we make it easier for employers to establish and expand pension and retirement plans. I look forward to working with members of this committee, this Congress, and the Administration to advance the goal of increasing pension savings opportunities for all Americans.

Chairman HOUGHTON. Thanks very much, Mr. Cardin. Mr. Weller.

Mr. WELLER. Well, thank you, Mr. Chairman. I am going to be brief just in my comments. And, first of all, I commend you for holding this hearing. And I also want to salute Speaker Hastert and Chairman Archer and Chairman Houghton for ensuring that retirement security is a priority in this Congress. And clearly it is with this hearing as well as the efforts we are making to extend the life of Social Security for another three generations.

In this particular hearing, I hope we look at and also discuss what I see clearly as some of the bias in the tax code that discourages individuals from savings and the bias in the tax code that discourages employers from providing more opportunity for retirement savings. Clearly, I want to salute my colleagues, particularly Congressman Portman and Cardin and others who have been real leaders over the last few years, in coming up with a bipartisan effort and, as they work through the process and put together an effort to encourage retirement savings. Clearly the opportunity to expand the opportunity to set aside more into your 401(k)s, your IRAs, to allow working moms to make up contributions in catch-up accounts so that they can better their retirement.

But I also believe we need to look at the bias in the law against multi-employer pension funds, particularly the 415 provisions. And we also need to look at ways to provide pension protections, particularly giving employees a better right-to-know protection so they can better understand the ramifications of any changes on their pensions.

So, with that, I want to thank the chairman for the opportunity to be here and, of course, I look forward to the witnesses testimony. And I do have a statement that I would like to submit for the record.

[The opening statement follows:]

Opening Statement of Hon. Jerry Weller, a Representative in Congress from the State of Illinois

I want to commend you for holding this hearing today continuing our efforts to ensure that employers have the flexibility they need to appropriately meet the retirement needs of their employees and that workers have the information they need to make the right decisions to prepare for their own futures.

As a large portion of today's population is nearing retirement, employer sponsored retirement plans have increased in importance. Their importance is especially heightened in the wake of continued reports about historically low savings rates among America's working population which is particularly problematic among the Baby Boomer generation that is rapidly joining those enjoying their retirement years.

I remain concerned that many workers simply do not understand their retirement benefits through no fault of their own, a problem which is exacerbated when their plan is unilaterally changed and employees are provided with minimal explanation about the effects on their own retirement plans.

In particular, reports about conversations from traditional defined benefit plans to cash balance or other hybrid plans have highlighted the need for more disclosure to be provided to negatively impacted employees.

Now, I want to recognize that many firms undergoing this type of conversion have been very forthright about providing full disclosure and others have tried to supplement those employees that would be negatively impacted. However, there have been numerous reports of employees who have found it difficult to get information on the impact so that they can make fully informed decisions about their professional futures. To be fair, the current law is minimalist in its approach to disclosure and some companies may be reluctant to provide additional information for which they might be held unjustly liable.

That is why I have introduced the Pension Right to Know Act with Representatives Ney and Bentson with companion legislation in the Senate sponsored by Senator Moynihan. This bi-partisan legislation will require increased disclosure of information to employees about their pension plan. It would require an explanation to the employee as to how their pension plan will be affected by any plan change. It will require an individual benefit statement for each employee showing how they, in particular, will be affected by this plan change. For some the change ill be beneficial, but for others the change could affect how they plan for the future.

I look forward to the testimony of he witnesses before us today about how we can help hard working Americans better plan for their retirement by encouraging both employers and employees to make well-informed decisions that will provide them with the most security possible.

Chairman HOUGHTON. Thank you very much. Mr. Cardin, I think you are right. I have just been at the Caribbean Basin Initiative, the hearing in 1100, and there are fewer people than there are here. [Laughter.]

Thank you very much, everybody, once again, for being here and I would like to ask the Honorable Donald Lubick, the Assistant Secretary for Tax Policy, the United States Department of Treasury, to testify.

STATEMENT OF HON. DONALD C. LUBICK, ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. LUBICK. Mr. Chairman, Mr. Coyne, Members of the subcommittee, I appreciate the opportunity to speak with you today regarding pension issues.

The Nation's private pension system has accomplished a great deal for many Americans. For millions, pension benefits are important in maintaining an appropriate standard of living in retirement. About 47 million workers in the private sector are earning pension benefits in their current jobs.

Working together in a bipartisan fashion over the past six years, the Administration and Congress have enacted important legislation that has enhanced pension coverage and security, improved retirement benefits for workers, improved portability, and simplified the pension law. We look forward to continuing to work with you to build on these past accomplishments.

Deferral of taxation of funded benefits is a statutory exception to the basic principle that the receipt of compensation is taxed currently. The qualified pension plan exception provides deferral of taxation on employer contributions and on earnings, preretirement, and is an inducement to secure broad retirement coverage of moderate and lower income workers. The nondiscrimination requirements are central to the goal of providing pension coverage and meaningful benefits for all workers.

To further the goal of broad pension coverage, any new or additional tax subsidies for retirement savings should satisfy several important principles.

First, any new tax preference should create incentives for expanded coverage and new saving, rather than encouraging individuals to reduce their taxable savings or increase borrowing to finance savings in tax-preferred form. Approaches targeted to moderate and lower-income workers are likely to be more efficient in generating new savings because these workers save less today and, therefore, have less existing savings to shift.

Second, to maintain fundamental fairness in the allocation of public funds, any new tax preference should be progressive, focused on expanding coverage for the millions of moderate and lower-income workers for whom saving is most difficult. Our policy should not be the simple pursuit of more plans, without regard to the resulting distribution of retirement and tax benefits.

Third, pension tax policy must take into account the quality of coverage. Will the employees who need coverage the most benefit and to what extent? Will retirement benefits actually be furnished to these workers, rather than only to those who individually choose to save by reducing their take-home pay?

The President has made clear that we must save Social Security first and then he further proposes to devote 12 percent of the unified surplus to establishing a new system of universal savings accounts or USAs. While the specifics of the USA proposal are not the subject of this hearing, we expect that these accounts will provide a tax credit to help millions of moderate and lower-income workers, including many part-time workers, save for their retirement in a manner that complements and strengthens the employer-provided retirement system.

Most workers not covered by employer-provided pensions are the lower-paid employees of small business or women. In conjunction with USAs, the President's Fiscal Year 2000 budget includes a number of other pension proposals that are targeted to these three groups and that satisfy the principles we have identified. I commend Congressman Neal for having introduced this legislation and I am pleased that, Mr. Chairman, that you have included it as part of the subject of this hearing.

These proposals, which are described in my written testimony, which is submitted for the record, include: a small business tax credit for expenses of starting a new retirement plan; a simplified, defined benefit-type plan for small business; IRA contributions through payroll deduction; improved portability among different types of plans; and improvements in vesting and annuity options to enhance retirement security for women.

Members of this committee and we share a common goal: to improve employer-provided retirement benefits and to increase all workers' retirement income security. And there is much common ground between our budget proposals and the members' bills, including the various portability provisions, the accelerated vesting provisions, and the tax credit for small businesses that create new plans.

Of course, the nondiscrimination and top-heavy safeguards play a crucial role in directing adequate benefits to moderate and lower-income workers, and changes to these rules should be considered only to the extent that this objective is not compromised. If the nondiscrimination or top-heavy protections were eliminated or inappropriately modified, then moderate- and lower-income workers would have smaller benefits and a larger number of short-service workers would risk forfeiting their benefits.

Some also suggest increasing maximum dollar limits for tax-qualified plans on the theory that this would help align the interests of decision-makers with the rest of the plan participants. They suggest that this would encourage more coverage while the nondiscrimination rules would provide moderate- and lower-paid workers with their fair share. We have concern with such an approach, especially if it's not part of broader legislation that promotes meaningful benefits for moderate- and lower-income workers. It should be demonstrated in each case that the particular proposal would contribute to an overall effective incentive for expanded coverage and new savings.

A very small percentage of retirement plan participants is affected by the current statutory limits, and those who are affected tend to be among the most highly paid individuals. To date, there is no reliable evidence to indicate that increased limits would result in any appreciable increase in plan coverage for moderate- and lower-income workers and that is a subject which I think we have to explore.

In addition, if the nondiscrimination rules, together with the related $160,000 limit on considered compensation, are weakened while the maximum dollar limits are increased, the increases are correspondingly less likely to improve coverage or benefits for moderate-and lower-paid workers, since raising considered compensation, for example, from $160,000 to $235,000, taken alone, will increase the relative share of plan benefits for higher paid employees. In cases in which the highly paid are satisfied with their current contributions, an increase in considered compensation might even provide an opportunity to maintain their desired benefits, but reduce contribution levels for most employees without any effect on themselves.

On the other hand, we share the concern that percentage of pay limits under defined contribution plans may inappropriately restrict retirement savings opportunities for some moderate- and lower-income workers, including those who have spent an extended period out of the work force. We will be pleased and look forward to working with the committee on targeted approaches to address these issues.

Proposals to increase contribution limits for IRAs and for *simple*, 401(k), and other salary reduction plans must be scrutinized carefully to determine the effect on new saving and benefits for moderate- and lower-income workers. Under current law, a small business owner who wants to save $5,000 or more for retirement on a tax-favored basis, generally would choose to adopt an employer plan. If the IRA limit were raised to $5,000, the owner could save that amount or, jointly with the owner's spouse, $10,000, on a tax-preferred basis, without adopting any plan for employees. Therefore, increases in the IRA limits could result in fewer employer plans for small businesses.

Similarly, if the owner wants to save, say, $15,000 in qualified plans, that cannot currently be done without providing employer contributions. If the 401(k) limit were increased to that amount, such an owner might no longer provide employer contributions. While 401(k) plans are highly desirable, defined benefit and employer-funded defined contribution plans play, and should continue to play, a central role in our pension system. Without such plans, there may be less retirement savings by those who are least able to save.

Similar concerns are raised by proposals for a $5,000 salary reduction *simple* plan that provides for no employer contributions.

These same considerations apply to proposals to add Roth-IRA type "designated plus accounts" to 401(k) plans and 403(b) annuities. Treating pretax contributions as "designated plus contributions" would effectively increase the limit on 401(k) and 403(b) pretax contributions and would eliminate or relax the income and contribution limits for Roth-IRA and would have other serious consequences.

Mr. Chairman, we appreciate the opportunity to discuss these important issues with you. We look forward to working with you and the other members of the committee to design and enact legislation that increases all workers' retirement income security and, in due course, I will be pleased to answer any questions that you or other members may have.

[The prepared statement follows:]

Statement of Hon. Donald C. Lubick, Assistant Secretary for Tax Policy, U.S. Department of the Treasury

It is a pleasure to speak with you today regarding pension issues. In accordance with the focus of this hearing, as described in the Subcommittee's announcement, our testimony will address issues relating to pension coverage and participation, particularly for low-income and part-time workers, women, and others who may not be adequately served by current law; ways to improve retirement benefits for workers; portability of pension benefits; and simplification of regulatory requirements. We will also describe the President's proposals to further these goals, strengthen the private pension system, and increase pension security.

The Nation's private pension system has accomplished a great deal for many Americans. Pension benefits have helped millions of people maintain their standard of living in retirement. More than $4 trillion in assets are now held in private retirement accounts. These assets are about 20 times greater than they were when ERISA was enacted in 1974. (Over $2 trillion more are held in plans of state and local governments.) Approximately 47 million workers in the private sector are earning pension benefits in their current jobs, and about two of three families will reach retirement with at least some private pension benefits.

Enhancing pension coverage and security, improving retirement benefits for workers, improving portability, and simplifying the pension laws has been a major focus of the Clinton Administration. Working together in a bipartisan fashion over the past six years, the Administration and Congress have enacted important legislation that has furthered these objectives. We look forward to working with Congress and especially with this Committee to build on these past accomplishments. Before proceeding further, it is worth noting several of these accomplishments.

I. Past legislative accomplishments

In 1993, the Administration submitted legislation that was enacted as the Retirement Protection Act of 1994, to protect the benefits of workers and retirees in traditional pension plans by increasing funding of underfunded defined benefit plans and by enhancing the Pension Benefit Guaranty Corporation's (PBGC) early warning and enforcement powers.

In 1995, the President introduced a package of pension simplification proposals at the White House Conference on Small Business. These proposals were targeted toward expanding coverage, with the particular goal of increasing the number of small businesses that offer retirement plans for their employees, and increasing pension portability. Many of these proposals—or variations on them—ultimately were enacted as part of the 1996 Small Business Job Protection Act. These pension provisions, the end product of seven years of bipartisan efforts, represented the most significant changes to the pension laws since the 1986 Tax Reform Act. Among the most important of these changes were:

- creation of a new, highly simplified 401(k)-type retirement savings plan for small business (the "SIMPLE"), which is proving to be quite popular with small employers;
- simplification of the nondiscrimination testing for 401(k) plans and the development of a design-based safe harbor permitting employers an alternative to 401(k) nondiscrimination testing;
- expansion of 401(k) plans to nongovernmental tax-exempt entities;
- elimination of the "family aggregation" rules that unduly restricted the ability of family members of small business owners and of other highly compensated employees to save for their own retirement; and
- elimination of the section 415(e) combined limits on benefits and contributions applicable to employees who participate in both defined benefit and defined contribution plans.

In 1997, the Taxpayer Relief Act included a number of other provisions that expanded the tax incentives for retirement savings, including

- expansions of individual retirement accounts (IRAs),
- repeal of the 15 percent excise tax on very large retirement distributions from qualified plans and IRAs, and
- an increase in the full funding limitation applicable to defined benefit pension plans.

We can take further steps to promote retirement savings and improve and strengthen our pension system by enacting legislation that will expand the number of people who will have retirement savings (particularly moderate- and lower-income workers not currently covered by employer-sponsored plans), improve workers' retirement benefits, and make pensions more secure and portable. Our focus should be on covering those who are left out of the current system and on improving the level of benefits of those whose current benefits are very modest.

II. Retirement Savings and Tax Policy

Background

Under our pension system, qualified plans are accorded special favorable tax treatment. A sponsoring employer is allowed a current tax deduction for plan contributions, subject to limits, while participating employees do not include contributions and earnings in gross income until they are distributed from the plan. Trust earnings accumulate tax free in the plan.

These important tax preferences for qualified plans are designed to encourage employers to sponsor retirement plans and to encourage participation by moderate- and lower-paid workers. It is often noted that pension coverage reduces the need for public assistance among retirees and reduces pressure on the Social Security system. See, e.g., Joint Committee on Taxation, Overview of Present-Law Tax Rules and Issues Relating to Employer-Sponsored Retirement Plans (JCX–16–99), March 22, 1999.

To ensure that benefits are provided by employers to moderate- and lower-income workers, qualified plans are subject to nondiscrimination rules. Any new pension proposals should be consistent with securing broad retirement coverage and nondiscriminatory benefits in employer-provided plans.

Standards for evaluating retirement savings proposals

It is important that any new or additional tax subsidies for retirement savings satisfy several key principles.

First, tax preferences should create incentives for expanded coverage and new saving, rather than merely encouraging individuals to reduce taxable savings or increase borrowing to finance saving in tax-preferred form. Targeting incentives at getting benefits to moderate- and lower-income people is likely to be more effective at generating new saving. In response to additional tax incentives, higher-income individuals are more likely to shift their savings from one vehicle to another, or offset savings with increased borrowing—instead of actually saving more. People who save less and have fewer financial resources to shift may be more likely to respond by actually increasing their saving.

Second, any new incentive should be progressive, i.e., it should be targeted toward helping the millions of hardworking moderate- and lower-income Americans for whom saving is most difficult and for whom pension coverage is currently most lacking. Incentives that are targeted toward helping moderate- and lower-income people are consistent with the intent of the pension tax preference and serve the goal of fundamental fairness in the allocation of public funds. The aim of national policy in this area should not be the simple pursuit of more plans, without regard to the resulting distribution of pension and tax benefits and their contribution to retirement security. The object of these tax preferences should not be to deliver the bulk of the benefits to those who need them least.

Third, pension tax policy must take into account the quality of coverage: Which employees benefit and to what extent? Will retirement benefits actually be delivered to all eligible workers, whether or not they individually choose to save by reducing their take-home pay? It is desirable to encourage measures that promote participation by lower- and moderate-income workers, such as employer-funded defined benefit or defined contribution plans, in addition to elective salary reduction arrangements.

Finally, any new or additional tax preferences must not undermine our fiscal discipline.

The President's Proposals

The President has made clear that in this era of surpluses we must save Social Security first. He proposes to commit 62 percent of the unified surplus for the next 15 years to Social Security and an additional 15 percent of the surplus to Medicare to assist retired workers in maintaining their health security.

While protecting the integrity of Social Security is our first priority, it should be possible to take other steps to enhance the retirement security of American workers by promoting new retirement savings for moderate- and lower-income workers many of whom currently lack coverage. The President proposes to devote 12 percent of the unified surplus to establishing a new system of Universal Savings Accounts (USAs) focused especially on those workers.

The President's fiscal year 2000 budget also includes a number of proposals that satisfy the principles outlined earlier and that will promote further expansion of workplace-based savings opportunities, particularly for moderate and lower-income workers not currently covered by employer-sponsored plans. These proposals, which are spelled out in greater detail below, include:

- a small business tax credit for expenses of starting a new retirement plan,
- the SMART—a simplified defined benefit-type plan for small business,
- IRA contributions through payroll deduction,
- improved portability among different types of plans, and
- improvements in the vesting and annuity options to enhance retirement security for women.

The USA account proposal and the pension proposals in the fiscal year 2000 budget reflect the principle that any new tax subsidies for retirement savings should be carefully targeted. To the extent possible, we should avoid providing additional tax subsidies for saving that would occur in any event—shifting of savings—which is often the case when the incentives are directed to higher-income individuals.

With this background in mind, I would now like to address the issues identified in the Subcommittee's announcement as the focus of this hearing.

III. Improving Portability of Retirement Savings

Over the years, the Administration and Congress have worked together on a bipartisan basis to greatly improve retirement savings portability for workers. The President's budget clearly reflects the Administration's desire to work with Congress to accomplish even more in this area. We must remember that there are at least two important elements in improving portability: accelerating vesting and making it easier to consolidate retirement savings. We commend Representatives Portman and Cardin and the other co-sponsors of H.R. 1102 for their leadership in promoting improvements in portability.

Accelerated Vesting for Matching Contributions

Currently, employer contributions to a plan, including matching contributions to a 401(k) plan, are required to become vested only after five years (or seven years if vesting is phased in). If an employee switches jobs after four years, all employer matching contributions could be forfeited. Under the President's budget, all employees must be fully vested in the employer's matching contributions after three years of service (or six years if vesting is phased in).

Consolidation of Retirement Savings

Under current law, there are many barriers to consolidating retirement savings. The President's budget takes significant steps toward eliminating these barriers, while balancing the need to prevent increased leakage from the retirement system. Leakage is a serious concern. Two thirds of workers who receive a lump sum distribution from a pension plan do not roll over the distribution to another retirement savings vehicle. Under the President's budget proposals

- A participant with an eligible rollover distribution from a qualified retirement plan would be able to roll the distribution into a section 403(b) tax-sheltered annuity, or vice versa. Under the proposal, such a rollover could occur directly or through an IRA.
- Amounts held in a deductible IRA also could be rolled over to an individual's workplace retirement plan. In addition to providing more opportunities to consolidate retirement savings, this proposal would help to simplify the existing "conduit IRA" rules.
- A participant in a state or local government section 457 plan would be able to roll a distribution from that plan into an IRA. This proposal would greatly increase payment flexibility for participants in these plans.

• A participant with after-tax contributions in a qualified plan would be able to roll those contributions into a new employer's defined contribution plan or into an IRA. Allowing these distributions to be rolled over would increase the chances that these amounts will be retained until needed for retirement.

• A new hire in the Federal government would be able to roll over a distribution from a prior employer's plan to the Federal Thrift Savings Plan. We think it is important for the Federal government to set an example for all retirement plan sponsors in this regard.

• An employee of a state or local government would be able to use funds in other retirement plans to purchase service credits in the state or local government's defined benefit plan without a taxable distribution. This provision would be particularly helpful in allowing teachers, who often move between different states and school districts in the course of their careers, to more easily earn a pension reflecting a full career of employment in the state in which they end their career.

We believe these proposals represent a significant step forward in the process of developing bipartisan consensus in the pension area. As noted, these proposals are substantially similar to those included in H.R. 1102 and have benefitted from discussion of these issues in this Subcommittee last year. We look forward to working with members and their staffs to resolve the remaining differences between these proposals.

IV. IMPROVING COVERAGE AND PARTICIPATION, PARTICULARLY FOR LOW-INCOME AND PART-TIME WORKERS AND WOMEN

While private pension coverage continues to grow, half of all American workers—more than 50 million people—have no pension plan at all. The bulk of the uncovered workers fall into one of three overlapping categories: lower wage workers, employees of small business, and women. The President proposes to address this low rate of coverage with a number of measures that are targeted to these three groups and that satisfy the principles we have identified.

Coverage of lower-wage workers and Universal Savings Accounts

Lower-wage workers are far less likely to be covered by a pension plan than higher income individuals. Over 80 percent of individuals with earnings over $50,000 a year are covered by an employer retirement plan. In marked contrast, fewer than 40 percent of individuals with incomes under $25,000 a year are covered by an employer retirement plan. In addition, the qualified plan rules do not require coverage of many part-time workers.

The President proposes to address these problems by devoting 12 percent of the unified surplus to establishing a new system of Universal Savings Accounts. While the specifics of this proposal are not the subject of this hearing, we expect these accounts to provide a tax credit to millions of lower-and middle-income workers, including many part-time workers, to help them save for their retirement. Millions of workers would receive an automatic contribution. Those who contributed additional amounts also would receive a matching contribution to their USA account. The matching contribution would be more progressive than current tax subsidies for retirement savings—helping most the workers who most need to increase retirement savings. By creating a retirement savings program for working Americans with individual and government contributions, we will help all Americans to become savers and enjoy a more financially secure retirement.

USA accounts are intended to help provide retirement savings to the millions of workers who are not covered by employer-sponsored pensions. In so doing, we expect USAs to be structured in such a way as to complement and strengthen employer-sponsored plans instead of substitute for them.

Small business tax credit for expenses of starting a new retirement plan

Although businesses with fewer than 100 workers provide 40 million jobs, only 20 percent—about 8 million of these employees—have pension coverage from their employer. In comparison, 62 percent of workers in firms with 100 or more employees have pension coverage.

The President's budget provides a three-year tax credit to encourage small businesses to set up retirement programs. The credit would be available to employers that did not employ, in the preceding year, more than 100 employees with compensation in excess of $5,000, but only if the employer did not have a plan or payroll deduction IRA arrangement during any part of 1997. In order for an employer to get the credit, the plan would have to cover two or more individuals.

For the first year of the plan, small businesses would be entitled to a credit, in lieu of a deduction, equal to 50 percent of up to $2,000 in administrative and retirement education expenses associated with a defined benefit plan (including the new SMART plan described below), 401(k), SIMPLE or other pension plan or payroll deduction IRA arrangement. For each of the second and third years, the credit would be 50 percent of up to $1,000 in such costs. The credit covers the expense of retirement education as well as administrative expenses because informed employees save more.

Promoting IRA contributions through payroll deduction

To make it easier for workers to contribute to IRAs, employers would be encouraged to offer payroll deduction. Contributions of up to $2,000 to an IRA through payroll deduction generally would be excluded from an employee's income, and, accordingly, would not be reported as income on the employee's Form W–2. Some employees would be able to use simpler tax forms. As evidenced by the rising participation rates in 401(k) plans, the greater convenience of saving through payroll deduction encourages lower-and moderate-wage earners to save more for retirement. Small businesses establishing such arrangements would be eligible for the new pension program start-up tax credit, provided the arrangement is made available to all employees of the employer who have worked with the employer for at least three months.

The SMART—a simplified defined benefit-type plan for small business

In 1996, the Administration and Congress created the SIMPLE plan—an easy-to-administer defined contribution plan for small businesses. However, there is no comparable tax-favored defined benefit pension plan that avoids the need for complex actuarial calculations, with the attendant administrative costs and unpredictability of funding requirements.

The President's budget proposes a simplified defined benefit-type plan for small business, the SMART plan (Secure Money Annuity or Retirement Trust). SMART combines many of the best features of defined benefit and defined contribution plans and provides another easy-to-administer pension option for small businesses. Because the SMART does not involve many employer choices regarding plan design or funding, many of the rules that govern these choices in defined benefit plans will not apply to the SMART. For example, the SMART Plans would not be subject to the nondiscrimination or top-heavy rules applicable to qualified retirement plans. SMART Plans also would not be subject to the limitations on benefits under section 415. Similarly, because SMART Plans do not have complex actuarial calculations, they would be subject to simplified reporting requirements. The minimum guaranteed benefit under the SMART Trust, described below, would be guaranteed by the PBGC—with a reduced premium of $5 per participant.

A business would be eligible to adopt a SMART Plan if it employed 100 or fewer employees with W–2 earnings over $5,000 and did not offer (and had not offered during the last five years) a defined benefit or money purchase plan. An employer that maintained a SMART Plan could not maintain additional tax-qualified plans, other than a SIMPLE plan, or a 401(k) plan or 403(b) tax-sheltered annuity plan under which the only contributions that are permitted are elective contributions and matching contributions that are not greater than those provided for under the design-based safe harbor for 401(k) plans.

SMART Plans would provide a fully funded minimum defined benefit, with a possible higher benefit if cumulative investment returns exceed 5 percent. Each year the employee participates, all eligible employees (employees with at least $5,000 in W–2 earnings with the employer in that year and in two preceding consecutive years) would earn a minimum annual benefit at retirement equal to 1 percent or 2 percent of compensation for that year. Moreover, an employer could elect, for each of the first 5 years the SMART Plan is in existence, to provide all employees with a benefit equal to 3 percent of compensation (in lieu of 1 percent or 2 percent of compensation). The maximum compensation that could be taken into account in determining an employee's benefit for a year would be $100,000 (indexed for inflation). Benefits would be fully vested.

Under the SMART, an employer would be required to contribute each year an amount sufficient to provide the annual benefit accrued for that year payable at age 65, using actuarial assumptions specified in the statute (including a five percent annual interest rate). The contributions would be allocated to a separate account to which actual investment returns would be credited for each employee. If a participant's account balance were less than the total of past employer contributions credited with five percent interest per year, the employer would be required to contribute an additional amount for the year to make up for any shortfall. Moreover, the employer would be required to contribute an additional amount for the year to make up for any shortfall between the balance in the employee's account and the purchase price of an annuity paying the minimum guaranteed benefit when an employee retires and takes a life annuity. On the other hand, if the investment returns exceeded the five percent assumption, the employee would be entitled to the larger account balance. If the employee elected to receive an annuity, the larger account balance would translate to a larger annuity.

If an employer did not wish to take on the risk that the cumulative investment return will be less than 5 percent or that the employee will choose an annuity when the insurance market is unfavorable, the employer could choose to purchase a SMART annuity instead. In the case of a SMART Annuity, each year an employer would be required to contribute the amount necessary to purchase an annuity that provides the benefit accrual for that year on a guaranteed basis.

SMART Plans would be subject to the qualified joint and survivor annuity rules that apply to qualified defined benefit pension plans. Lump sum payments also could be made available. No distributions would be allowed from a SMART Plan prior to an employee's attainment of age 65, except in the event of death or disability, or where the account balance of a terminated employee was not more than $5,000. However, an employer could allow a terminated employee who has not yet attained age 65 to directly transfer the individual's account balance from a SMART Trust to either a SMART Annuity or a special individual retirement account ("SMART Account") that is subject to the same distribution restrictions as the SMART Trust.

If a terminated employee's account balance did not exceed $5,000, the SMART Plan would be allowed to make a cashout of the account balance. The employee would be allowed to make a tax-free transfer of any such distribution to a SMART Annuity, a SMART Account, or a regular IRA.

Distributions from SMART Plans would be subject to tax under current rules applicable to the taxation of annuities. A 20 percent additional tax would be imposed for violating the pre-age 65 distribution restrictions under a SMART Annuity or SMART Account.

Enhanced retirement security for women

Women receive lower pension benefits than men. Only 30 percent of all women age 65 or older were receiving a pension in 1994 (either worker or survivor benefits), compared to 48 percent of men. Women's pensions are typically smaller than those received by men. Among new private sector pension annuity recipients in 1993–94, the median annual benefit for women was $4,800, or only half of the median benefit of $9,600 received by men.

The President's proposals include a number of provisions that—while gender neutral—would have the primary effect of benefitting women. For example, workers who take time off under the Family and Medical Leave Act (FMLA) would be able to count that time toward retirement plan vesting and eligibility requirements. In some cases, counting time taken under FMLA can make the difference between receiving or not receiving credit toward minimum pension vesting requirements.

The budget would make a 75 percent (or higher) joint and survivor annuity universally available in plans that are subject to the joint and survivor rules. Having higher survivor annuities could reduce the number of elderly widows living in poverty. Under current law, workers are given the option of a single life annuity, which pays only during the life of the covered employee, or a "joint and survivor annuity" which typically pays a lower pension benefit during the lifetime of the retiree, but continues to pay 50 percent of the amount to a retiree's surviving spouse. Unfortunately, the income a surviving spouse needs to live on is often more than 50 percent of the pension payable while the worker is alive. Many couples may prefer an option that pays a somewhat smaller benefit to the couple while both are alive, but provides a larger benefit—75 percent of the joint annuity amount—to the surviving spouse. In addition, the spouse would be required to receive the same explanation of the worker's choices that the worker receives.

Plan vesting requirements have an especially adverse impact on female employees who tend to have shorter job tenure. As described above, under the President's budget, all employees must be fully vested in the employer's matching contributions after three years of service (or six years if vesting is phased in).

Retirement Savings Education

One key to improving coverage and participation by workers is to address the relative lack of employee demand. Even among workers whose employers offer plans, many fail to take advantage of the retirement savings opportunities available. Nearly 40 percent of employees earning less than $50,000 a year who are eligible to save through a 401(k) plan fail to participate.

Educating workers about the importance of saving for retirement and about investment and financial choices may be quite helpful. A recent study, for example, found that education in the workplace tended to increase participation of workers in 401(k) plans. The role of education in this area and the educational efforts that have been undertaken by the Administration will be addressed by the Department of Labor in its testimony before this Subcommittee today.

V. IMPROVING BENEFITS FOR WORKERS

We share with the Committee the goal of increasing workers' retirement income security. Of course, the nondiscrimination and top-heavy safeguards play an important role in directing adequate benefits to moderate- and lower-income workers under tax-qualified retirement plans, and changes to these rules should be considered only to the extent that this objective is not compromised. We also believe it is important to encourage employers to adopt plans that provide retirement benefits to all covered employees, in addition to salary reduction arrangements (which may not benefit workers who are unable to save). As noted, the President's budget also proposes to improve benefits by accelerating vesting.

Nondiscrimination Rules

The nondiscrimination standards benefit the majority of employees by requiring the employer to provide benefits to them as a condition of receiving tax-favored status for its retirement plans. Higher paid employees are typically very interested in saving for their retirement, and many of them would save even in the absence of an employer plan. On the other hand, many lower-paid employees understandably prefer receiving a larger portion of their total compensation package in the form of current pay, rather than in retirement plan benefits, given scarce resources to meet current expenses. However, it is just these types of lower-paid employees—who are unable to save on their own—who need the most help in saving for retirement.

If the nondiscrimination rules were relaxed, some employers could respond by increasing the benefits provided to their higher paid employees without increasing the benefits provided to the rest of their employees. Alternatively, the employer could maintain the current contribution level for the higher paid employees and respond to other employees' desire to shift their compensation package to cash compensation by reducing their retirement benefits. Further reductions in the already low rate of savings for lower-paid employees would have consequences for our entire society.

Top-Heavy Safeguards

The top-heavy safeguards serve as a safety net for lower-and moderate-wage workers, delivering benefits to those workers when the nondiscrimination rules are not adequate to the task. A tax-qualified plan is considered top-heavy whenever 60 percent of the value of the benefits provided under the plan inure to key employees (i.e., certain owners and officers). If a plan is top-heavy, it must provide certain minimum benefits or contributions and must accelerate vesting.

Some pension practitioners have traditionally used their ingenuity to find gaps in the nondiscrimination rules in order to allow plan sponsors to save costs by minimizing the benefits provided to moderate- and lower-paid employees. Some of the more aggressive approaches have resulted in very large disparities in benefits between key and non-key employees. For example, without top-heavy safeguards, some plans could provide as much as $30,000 of annual tax-favored contributions to key employees and as little as one percent of pay to younger non-key employees. The top-heavy rules fill a portion of those gaps by requiring a minimum contribution for all non-key employees that is generally equal to three percent of pay.

As noted, the top-heavy rules apply only when more than 60 percent of the benefits in a plan are concentrated among a limited group of key employees—often as a result of non-key employees terminating without vesting or because an employer's demographics accommodate a plan design that takes advantage of the permitted disparity in the nondiscrimination rules in order to provide more benefits to higher paid employees. By requiring at least a minimum level of benefits for all employees and accelerating vesting, the top-heavy rules play a very important role in leveling the playing field for workers in these cases.

We do, however, believe that some elements of proposals to simplify the top-heavy rules warrant serious consideration, and we would be pleased to work with this Committee in that regard. However, we have serious concerns about various elements of current top-heavy simplification proposals, particularly provisions that would undermine the ownership attribution rules, which apply not only for purposes of the top-heavy rules, but for purposes of the other pension nondiscrimination rules as well.

A fundamental principle underlying the Internal Revenue Code is that tax rules should not be avoided by simply shifting ownership of a business among family members. Proposed changes in the ownership attribution rules would virtually eliminate the obligation to provide fair benefits to non-family member employees in small business retirement plans. For example, under a proposed change, a business run by two spouses who also employed a full-time non-family member would be able to exclude that employee from a retirement plan covering the two spouses as long as the business was legally owned solely by either spouse. Obviously, such a proposal could reduce coverage substantially among workers in small businesses and is inconsistent with our efforts to expand coverage of those workers.

The top-heavy and nondiscrimination protections benefit the American taxpayer and protect the integrity of the pension tax preference by ensuring that the tax preference is utilized by workers throughout the income spectrum and does not serve primarily as a tax shelter for higher-income individuals. Any modifications that might be made to the top-heavy or nondiscrimination protections must not result in moderate-or lower-income workers receiving smaller benefits or in a larger number of short-service workers forfeiting their benefits.

401(k) Safe Harbor

The President's budget proposes to improve the benefits of workers by modifying the rules applicable to the safe harbor 401(k) plan. Under this plan design, an employer is not required to determine the rate at which nonhighly compensated employees are participating in the plan, if the employer provides a specified matching contribution formula. To increase the participation rate of nonhighly compensated employees, the budget would specify a minimum period following the receipt of an explanation of the plan during which employees could choose to participate in the plan for the upcoming year and would require that all employees covered under a safe harbor 401(k) plan receive a small nonelective contribution equal to one percent of pay. Receiving account statements showing this contribution and the tax-free compounding of interest would stimulate the saving habit among current nonsavers and encourage vendors to market savings to those workers and their families.

Effect of Increased Dollar Limits on Moderate- and Lower-Income Workers

We share the concern that percentage-of-pay limitations under defined contribution plans may inappropriately restrict retirement savings opportunities for some moderate- and lower-income workers, including those who have spent an extended period out of the workforce. We would be pleased to work with the Committee on targeted approaches to address these issues. For example, while a wholesale repeal of these limits may not be necessary, a more targeted approach may be to explore whether there is some minimum dollar level of contribution that could address these concerns, similar to the minimum dollar benefit accrual allowed for defined benefit plans. In addition, it is important to ensure that any changes to percentage of pay limitations avoid weakening nondiscrimination tests that are based on employee percentage of pay averages.

Some also suggest increasing maximum dollar limits for tax-qualified plans, on the theory that this would align the interests of decision makers with the rest of the plan participants. They suggest that this would encourage more coverage while the nondiscrimination rules would provide moderate- and lower-paid workers with their fair share. We have several concerns about such an approach, especially if not part of a significantly broader legislative strategy that ensures meaningful benefits for moderate- and lower-income workers. It would need to be demonstrated in each case that the particular proposal would function as an effective incentive for new coverage and new saving, given that a very small percentage of retirement plan participants is affected by the current statutory limits, and the individuals affected tend to be among the wealthiest of Americans. To date, there is no reliable evidence to indicate that these additional tax preferences will result in any appreciable increase in new plan coverage.

Moreover, recent changes in law, such as the repeal of the 15 percent excise tax on very large retirement distributions from qualified plans and IRAs, have already increased the amount that higher-income individuals can save on a tax-favored basis. Some of the 1996 and 1997 provisions have only recently become effective, and the repeal of the combined maximum limits on tax-qualified benefits and contributions—a major simplification that could increase significantly the ability of higher-income individuals to accumulate tax-qualified benefits—will not become effective until next year. It is still too early to assess the impact of these expanded tax incentives to establish plans.

In addition, if the nondiscrimination rules (and the limit on considered compensation under section 401(a)(17)) were weakened at the same time maximum dollar limits were increased, the limit increases would be correspondingly less likely to improve coverage or benefits for moderate- and lower-income workers who are currently covered under retirement plans. In fact, an increase in the considered compensation limit from $160,000 to $235,000 increases the relative share of plan benefits that go to higher paid employees. For example, simultaneous increase in the compensation and contribution limits will not require an improvement in a plan contribution formula in order for individuals whose compensation exceeds $160,000 to take advantage of a section 415(c) contribution limit increase from $30,000 to $45,000. Where the highly paid are satisfied with current benefit levels, an increase in considered compensation may even provide an opportunity to reduce benefit levels for most employees without affecting benefits for the highly paid.

Of course the overall impact of any legislative changes of this particular type would need to be assessed in the context of other provisions that might be enacted at the same time, especially broad initiatives to deliver significant additional retirement savings to lower- and moderate-income workers. I would like to reiterate that we will be happy to work with the Committee on appropriate means of expanding retirement savings opportunities for these workers.

Increases in IRA and Salary Reduction Contribution Limit

We share the goal of increasing retirement savings. At the same time, proposed increases in contribution limits for IRAs and for SIMPLE, 401(k), and other salary reduction plans must be scrutinized carefully to assess their effect on sound pension policy. We should examine the efficiency of such proposals in terms of increasing retirement savings, and their effect on coverage for moderate- and lower-income workers. For example, increases in the 401(k) contribution limit would benefit a relatively small number of taxpayers who have the ability to set aside these amounts in a 401(k) plan, and who may well only shift existing savings to their 401(k) plan.

Increases in IRA limits are likely to attract additional deposits by higher-income taxpayers who are already saving for retirement, and who may merely shift their additional IRA contributions from other savings. Currently, a small business owner who wants to save $5,000 or more for retirement on a tax-favored basis generally would choose to adopt an employer plan. However, if the IRA limit were raised to $5,000, the owner could save that amount—or jointly with the owner's spouse, $10,000—on a tax-preferred basis without adopting a plan for employees. Therefore, higher IRA limits could reduce interest in employer retirement plans, particularly among owners of small businesses. If this happens, higher IRA limits would work at cross purposes with other proposals that attempt to increase coverage among employees of small business.

Similarly, if the owner wants to save, say, $15,000 a year in a qualified plan (as opposed to the $10,000 that can currently be saved via 401(k) salary reduction), the owner has an incentive to adopt a plan that provides employer contributions to employees. The limit on 401(k) contributions and the resulting pressure to provide employer contributions serves a useful purpose in our system. Increasing the 401(k) limit may prompt employers to substitute expanded voluntary salary reduction opportunities for employer contributions. While 401(k) plans are highly desirable, defined benefit and employer-funded defined contribution plans play—and should continue to play—a central role in our pension system. These plans provide benefits to lower-paid workers regardless of whether they individually choose to save by reducing their take-home pay. Fewer employer-funded benefits and contributions may mean less retirement savings by the lower-and moderate-income workers who have the greatest difficulty saving for retirement.

Some may respond to this concern by contending that employers will not reduce employer-funded contributions in favor of IRAs or voluntary salary reduction elective arrangements if maximum dollar limits for employer-funded plans are also increased when limits are increased for IRA and 401(k) contributions. However, whatever the relative levels of permissible tax-favored contributions might be among different types of plans, the absolute amount of IRA plus salary reduction contributions that would be permitted if both of those limits were increased [combination of higher IRA contribution limits and higher salary reduction contribution limits] may be enough to satisfy the desire for tax-favored retirement savings on the part of many decision-makers, including many small business owners.

Similar concerns are raised by proposals for a $5,000 SIMPLE plan that provides for no employer contributions. Surveys suggest that the popularity of SIMPLE plans with small businesses is already exceeding expectations in the two years since SIMPLEs became available. The SIMPLE plan requires only a modest, but important, employer matching or automatic contribution. A proposal that allows $5,000 of employee pretax contributions without either nondiscrimination testing or employer contributions would certainly undermine the SIMPLE plan. Furthermore, in combination with a $5,000 IRA contribution limit proposal, there could be substantial displacement of not only SIMPLE plans but also 401(k) plans (which have nondiscrimination standards or safe harbor employer contributions) and other employer plans. The Administration's payroll deduction IRA proposal, which is based on current law IRA limits, is a better approach to addressing small businesses' concerns about financial commitment, without undermining the success of SIMPLE plans.

Similar considerations apply to proposals to add Roth-IRA type "designated plus accounts" to 401(k) plans and 403(b) annuities. Treating pre-tax contributions as "designated plus contributions" would effectively increase the limit on 401(k) and 403(b) pre-tax contributions. They would eliminate or relax the income and contribution limits for Roth IRAs, and would have other serious consequences.

Catch-up Contributions

We are sympathetic to concerns that those who have spent extended periods out of the workforce may encounter obstacles to "catching up" on retirement savings needs. Obviously, the most important obstacle in this regard is an individual's own financial ability to increase savings. With respect to the employer plan system, evidence suggests that nonstatutory limits imposed by plans or employers (e.g., limiting salary reduction contributions to ten percent of pay) are a significantly greater barrier to catch-up contributions than the statutory $10,000 401(k) contribution limit. In fact, only a small percentage of participants over the age of 50 are actually affected by the $10,000 contribution limit, and those tend to be among the highest-income individuals.

We think it is worth exploring ways to address barriers to increasing savings, particularly for those over the age of 50. In so doing, it may be more appropriate to focus on percentage-of-pay limitations, particularly as applied to lower-income workers, as discussed earlier.

VI. Simplifying Regulatory Requirements

Another area of bipartisan accomplishment has been pension simplification, particularly as part of the 1996 Small Business Job Protection Act. Further improvements can be made to promote simplification, provided that there is an appropriate balance between simplifying rules and protecting workers, so that moderate- and lower-income workers receive a fair share of retirement benefits.

For example, the President's budget includes a proposal to simplify the definition of a highly compensated employee. The definition would be modified to eliminate the complex option to treat all employees earning below the 80th percentile in an employer's workforce as nonhighly compensated employees. This will ensure that all employees earning over $80,000 are classified as highly compensated employees for qualified plan nondiscrimination testing purposes. This would not only make the law simpler, it would also make it more fair. Under current law, an executive or professional earning hundreds of thousands of dollars can be classified as a nonhighly compensated employee for nondiscrimination testing if the individual is below the 80th percentile (which can occur in a small firm with several highly paid executives or professionals) unless the person is a five-percent owner of the business.

Some have proposed allowing employers a deduction for dividends paid to an employee stock ownership plan (ESOP) when employees elect to leave the dividends in the ESOP. Current law allows employers to deduct ESOP dividends if they are distributed from the plan or used to pay certain ESOP indebtedness. Proponents argue that this proposal would simplify administration by making it unnecessary for a participant to make an offsetting 401(k) plan election if the participant prefers to defer tax on income equal to the amount of the dividend. However, the proposal would need to be modified to treat the employee's election to leave dividends in the ESOP in the same manner as any other cash or deferred election. Otherwise the provision would allow ESOP participants 401(k)-type cash-or-deferred elections that are not subject to the $10,000 limit and that are not subject to nondiscrimination standards. Further, unless the election is subject to the 401(k) rules, the proposal might make it easier for C corporations that are substantially owned by ESOP participants to effectively avoid federal taxes on all corporate earnings.

Simplicity Versus Flexibility

Complexity of pension rules is often attributable to employers' desire for certainty while at the same time accommodating a wide range of plan designs and practices to satisfy various corporate objectives. Accordingly, major simplification of the pension rules is likely to come only at the price of curtailing the extensive flexibility employers currently enjoy.

The pension nondiscrimination regulations reflect the effort to combine certainty with flexibility. These regulations, which were finalized in 1993, were the product of an unprecedented amount of dialogue between the government and plan sponsors, following multiple rounds of comment, discussion, and revision. Plans have long since been amended to reflect the regulations.

These regulations address the complexity issue by providing a set of safe harbors that allow employers to avoid nondiscrimination testing by retaining or adopting straightforward plan designs that provide uniform benefits to participants. These plans pass the nondiscrimination tests regardless of the characteristics of the employer's workforce. Today, well over 90 percent of qualified plans use these safe harbor designs.

Compliance Programs

Another example of easing regulatory burdens without weakening worker protections may be found in the compliance programs maintained by the Internal Revenue Service. Since 1990, the Service has maintained a number of compliance programs to enable correction of retirement plans that fail to meet tax-qualification requirements. These programs have evolved over the years in response to taxpayer suggestions, and there has been widespread appreciation for how successful the programs have been.

Some legislative proposals would effectively undermine these programs and would adversely affect compliance. The programs reflect the principle that plan sponsors need a carefully graduated series of stages in the process to make sure that the sponsor always has the incentive to avoid delaying correction to a later date—especially an incentive to correct shortly after the error has occurred when correction is easy and before participants have been harmed. The incentive structure should also ensure that if the error has not been corrected within a specified time, the sponsor will have a further incentive to correct at the next stage in the process.

Pending legislative proposals would restrict the flexibility that is currently essential to the administrative compliance programs. Some proposals, for example, would fail to require full correction of qualification errors, even in the case of significant violations. For instance, if a plan discovered it had failed to pay 401(k) benefits to 20 retired participants, the current programs would encourage prompt correction after discovery of the failure. By contrast, under legislative proposals, the sponsor would not be required to take any corrective action unless and until the audit notice cycle began, and then would be required to correct only for most of the participants. These proposals would not allow the IRS to require that benefits ever be paid to the remaining participants, even if the plan could easily pay the benefits and even after audit. These legislative proposals also would dramatically revise the tax consequences for disqualification, removing the primary compliance incentive for plans that cover predominantly nonhighly compensated employees, such as multi-employer plans or plans of businesses in financial distress for which loss of an income tax deduction or a tax on trust earnings is not important. Such changes could undermine the IRS administrative compliance and correction programs, which have been widely recognized as improving plan compliance.

To protect participants while lessening regulatory burdens, we need to continue developing and improving flexible programs, such as the Employee Plans Compliance Resolution System, that create appropriate incentives, as opposed to enacting legislation that might impede innovation and flexibility. The productive administrative process that has developed and expanded these compliance programs requires maximum flexibility, feedback, and adaptation. These favorable results can best be achieved through the kind of administrative approach involving the pension community that has been undertaken in recent years.

The Treasury Department appreciates the opportunity to discuss these important issues with Members of this Subcommittee, and we would be pleased to explore these issues further.

Mr. Chairman, this concludes my formal statement. I will be pleased to answer any questions you or other Members may wish to ask.

Chairman HOUGHTON. Thank you very much, Mr. Lubick. Our timer seems to have gone off and so, therefore, I have devised a new routine. Since you have five minutes, at the end of four minutes, I will bang my gavel which means that you have another minute. And so that will give you fair warning. I hope that is all right with you.

The next witness is Leslie Kramerich, who is Deputy Assistant Secretary for Policy of the Pension and Welfare Benefits Administration in the Department of Labor. And also David Strauss who, as many of you know, is the Executive Director of the Pension Benefit Guaranty Corporation. So would you begin Ms. Kramerich.

STATEMENT OF LESLIE B. KRAMERICH, DEPUTY ASSISTANT SECRETARY FOR POLICY, PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Ms. KRAMERICH. Thank you, Mr. Chairman, members of the subcommittee. I am Leslie Kramerich, Deputy Assistant Secretary for Policy of the Pension and Welfare Benefits Administration for the Department of Labor. And I appreciate this opportunity to appear before you today to discuss the status of our private pension system and our efforts to improve that system. The Department is very well aware of the important role this subcommittee has played to ensure that our Nation's workers realize the retirement benefits they have earned.

Only two generations ago, a so-called comfortable retirement was the almost exclusive province of a privileged few. For many, old age was often characterized by poverty and insecurity. Today the majority of American workers and their families can look forward to spending their retirement years in relative comfort. Our private pension system has played a crucial role in accomplishing this turn around. Today more than 8.5 million retirees receive checks every month from the private pension fund of an employer. And another 4 million have received a lump sum payment.

For retirees aged 65 and older who receive pensions, the benefits represent more than one-fourth of their total income. And for those aged 55 to 64, the pension represents over one-third of their income. Clearly Social Security alone is not enough and a rare few will find their own individual savings to be enough to preserve their standard of living into retirement. The private pension system is an indispensable part of the retirement security of American workers and their families.

Approximately 47 million private sector workers are earning pension benefits in their current jobs. This is more than four times as many as——

Chairman HOUGHTON. Could I ask you—could you stop? Can you hear? Is it difficult? Yes, could you speak a little closer to the mike? See if you can.

Ms. KRAMERICH. Yes, Mr. Chairman. All right.

Chairman HOUGHTON. Yes, that is fine. All right. Good.

Ms. KRAMERICH. Approximately 47 million private sector workers are earning pension benefits in their current jobs. This is more than 4 times as many as 50 years ago and nearly twice the number as recently as the late 1960's. The assets of the private pension system exceed $4 trillion. And this represents in excess of one-seventh of the financial assets in the economy and far exceeds the total Gross Domestic Product of most other nations.

Despite these remarkable achievements, much more remains to be accomplished. Although millions of workers are joining the system, the proportion of the work force participating has remained virtually constant for almost three decades. In addition, there are troublesome gaps in coverage. Despite substantial gains in recent years, the proportion of women earning and receiving pension benefits remains well below that of men. The gap for minority groups remains even larger. While about one-half of white workers in the private sector are accruing benefits, only about one-third of African-American and one-quarter of Hispanic workers have been brought into the system.

The challenge before us today is not simply to expand coverage, but to expand it in a manner that gives high priority to reducing these gaps. An enormous part of this challenge is the result of the essential fact that our private pension system is a voluntary system. We encourage employers and workers to perceive their mutual advantage in allocating some portion of the compensation due workers toward savings for retirement. There are a wide array of pension arrangements available to employers. That variety is intended to provide the flexibility needed in a diverse and dynamic economy.

When you set out to design a variety of options to appear to a variety of employers in a variety of industries, professions, and sizes, and then you try to tailor other requirements of fair coverage and security under those options, it is probably not surprising that after a while what was intended as desirable flexibility starts to look like burdensome complexity. Before we act too quickly to simplify, we need to look carefully at what can truly be cleared away and distinguish that from fundamental values that must be preserved.

That may be harder than ever to do. Given the complexity of the current landscape, the unintended consequences of what may seem to be simple solutions to simple problems are rarely readily apparent. An effort to enhance the attractiveness of one new type of pension plan may simply create an inferior substitute for an existing plan resulting in nothing more than reshuffling current coverage, rather than any new coverage. Or, worse, substituting plans that provide less than had been offered.

We believe it is helpful to continually ask why we are considering certain changes and what we hope they will accomplish. Increasing the attractiveness of certain pans is a goal we all share. The administration has put forward options. Members, including many of the leaders on this committee have put forward options, our ERISA advisory council to the Department of Labor has put forward options. Some addressed increasing annual limits on contributions or compensation or benefits. And those are described as restoring the adequacy of coverage and increasing employer interest in plans by increasing the company's decision-makers financial stake in the plan.

How can we be sure that if we recommit the company's top officials to a qualified plan, this rising tide will lift all boats? We have to be sure that provisions like this deliver to everybody, not just a few. That is the challenge we share. Hopefully, a rising tide will lift all boats, but we see several problems with that. First, not everybody has a boat and we want to work with you on that. Second, in dealing with legislation this complex, it is especially important that we work together to to prevent unintended consequences.

Achieving the delicate balance between incentives to create pension plans and requirements to ensure broad access and fairness is one that is not easily reached, yet remains within our grasp. Many argue that the static coverage numbers and the impending retirement of the baby boom generation necessitate an expansion of the financial incentives for employees to sponsor pension plans. We must, however, ensure that the benefits reach middle-and lower-income workers, as well as the highly paid, and that new coverage does not come at the cost of the hard-won gains of the past. Both of these goals deserve attention.

Must progress has been made over the past year. Both the administration and Members of Congress have put forth thoughtful and meaningful proposals. We want to work together to meld the best aspects into legislation that can achieve our goals. Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Leslie B. Kramerich, Deputy Assistant Secretary for Policy, Pension and Welfare Benefits Administration, U.S. Department of Labor

Mr. Chairman and Members of the Subcommittee, I am Leslie Kramerich, the Deputy Assistant Secretary for Policy at the Pension and Welfare Benefits Administration of the U.S. Department of Labor. I appreciate this opportunity to appear before you to discuss the status of our private pension system and our efforts to improve that system. The Department is well aware of the important role this Subcommittee has played to ensure that our Nation's workers realize the retirement benefits that they have earned.

Although the focus of today's hearings is properly on the shortcomings of our private pension system, we should not lose sight of what a remarkable success the system represents. Only two generations ago a so-called "comfortable retirement" was the almost exclusive province of a privileged few; for many, old age was often characterized by poverty and insecurity. Today the majority of American workers and their families can look forward to spending their retirement years in relative comfort.

Our private pension system has played a crucial role in accomplishing this turnaround. Today more than 8½ million retirees are receiving monthly checks from the private pension fund of an employer and another 4 million have received a lump sum payment. For retirees age 65 and older who receive pensions, the benefits represent more than one-fourth of their total income and for those age 55–64 the pension represents over one-third of their income. Clearly, Social Security alone is not enough, and a rare few will find their own individual savings to be enough to preserve their standard of living into retirement. The private pension system is an indispensable part of the retirement security of American workers and their families.

Approximately 47 million private sector workers are earning pension benefits in their current jobs. This is more than four times as many as fifty years ago and nearly twice the number as recently as the late 1960's. The assets of the private pension system exceed $4 trillion. This represents in excess of one-seventh of the financial assets in the economy and far exceeds the total Gross Domestic Product of most other nations.

EXPANDED COVERAGE

Despite these remarkable achievements much more remains to be accomplished. Although millions of workers are joining the system, the proportion of the workforce participating has remained virtually constant for almost three decades. In addition there are troublesome gaps in coverage. Despite substantial gains in recent years, the proportion of women earning and receiving pension benefits remains well below that of male workers. The gap for minority groups remains even larger. While about one-half of white workers in the private sector are accruing benefits, only about one-third of African American and one quarter of Hispanic workers have been brought into the system.

The challenge before us today is not simply to expand coverage, but to expand it in a manner that gives high priority to reducing these gaps.

An enormous part of this challenge is a result of the essential fact that our private pension system is a voluntary system. We encourage employers and workers to perceive their mutual advantage in allocating some portion of the compensation due workers toward savings for retirement. There are a wide array of pension arrangements available to employers; that variety is intended to provide the flexibility needed in a diverse and dynamic economy.

When you set out to design a variety of options to appeal to a variety of employers in a variety of industries, professions, and sizes, and then you try to tailor other requirements of fair coverage and security onto those options, it's probably not surprising that after a while what was intended as "desirable flexibility" starts to look like "burdensome complexity." Before we act too quickly to "simplify," we need to look carefully at what can truly be cleared away and distinguish that from fundamental values that must be preserved.

That may be harder than ever to do. Given the complexity of the current landscape, the unintended consequences of what may seem to be simple solutions to simple problems are rarely readily apparent. An effort to enhance the attractiveness of one new type of pension plan may simply create an inferior substitute for an existing plan, resulting in simply re-shuffling current coverage rather than any new coverage—or worse, substituting plans that provide less than had been offered.

We believe it's helpful to continually ask why we are considering certain changes, and what we hope they'll accomplish. For example, increasing the attractiveness of certain retirement plans is a goal we all share. The Administration has put forward options; Members including many leaders on this Committee have put forward options; the ERISA Advisory Council to the Department of Labor has recommended options. Some of those options address increasing annual limits on contributions or compensation or benefits. Those are described as restoring the adequacy of coverage and increasing employer interest in plans by increasing the company's decision makers financial stake in the plan.

How can we be sure that if we recommit the company's top officials to a qualified plan, this rising tide will lift all boats? We have to be sure that provisions like this deliver to everybody, not just a few—that's the challenge we share.

Hopefully, a rising tide will lift all boats. But we see several problems with that. First, not everybody has a boat, and we want to work on that. Second, in dealing with legislation this complex, it is especially important that we work together to prevent unintended consequences.

Achieving the delicate balance between incentives to create pension plans and requirements to ensure broad access and fairness is one that is not easily reached yet remains within our grasp. Many argue that the static coverage numbers and the impending retirement of the "baby boom" generation necessitate an expansion of the financial incentives for employers to sponsor pension plans. We must, however, ensure that the benefits reach middle and lower income workers as well as the highly paid, and that new coverage does not come at the cost of the hard won gains of the past. Both of these goals deserve attention.

Much progress has been made over the past year. Both the Administration and Members of Congress have put forth thoughtful and meaningful proposals. We need to work together to meld the best aspects into legislation that can achieve our goals.

We must keep in mind the current status of private pension coverage. According to the latest comprehensive data, in 1993 about 43% of all private wage and salary worker were covered by a pension plan. For full-time workers the rate is somewhat higher, at 50%. These coverage rates have been relatively flat over the past 25 years varying only a couple of percentage points.

This lack of real growth has occurred despite an increase in both plan sponsorship and coverage within all major industry groups. This seemingly contradictory outcome appears to be associated with several offsetting trends occurring within the labor force and in the types of pension plans offered workers. Over the past three decades there has been a significant shift in employment away from manufacturing and toward service industry jobs. From 1979 to 1998 the percentage of private sector workers employed in manufacturing industries decreased from 30% to 20% while the percentage of workers employed in the service industries increased from 22% to 32%. This has had a dampening effect on pension coverage because the manufacturing sector, in which our private pension system largely originated, has one of the highest coverage rates at 63% of workers compared to 35% in services. While the coverage rate in service industries increased from 30% in 1979 to 35% in 1993, this has not been enough to offset the shift in employment from high to low coverage industries to produce an overall coverage increase.

We have also been experiencing a trend toward part-time work. The percentage of workers employed on a part-time basis increased from 15% in 1979 to 18% in 1998. This has had a similarly constraining effect because the coverage rate is only 12% among part-time workers compared to 50% for full-time workers.

Perhaps most significant, there is a strong and continuing shift in the types of pension plans being offered workers, from defined benefit plans to defined contribution plans. Much of this is the result of the explosion in the growth of 401 (k) plans which now include almost the majority of private sector workers with pension coverage as either their primary or supplemental plan. The phenomenal growth in 401(k) plans in recent years has led to an increase in the percentage of the labor force employed by firms with some type of plan—from 61% in 1988 to 65% in 1995.

The higher sponsorship rate, however, has not led to an overall increase in plan participation. This is partly due to the frequent use of a service requirement for participation. In addition, participation in these plans is generally elective by the worker, and only about two-thirds of the workers in firms with these plans are participating in them. This is particularly an issue among younger and lower wage workers, two groups that any meaningful coverage expansion will have to reach. This highlights the crucial fact that we must keep in mind the worker side of the coverage equation.

As a result of these trends, non-covered workers have been increasingly concentrated among certain segments of the labor force. Workers without pensions are most likely to be employed by small firms, to receive low wages, to be young, to have low tenure, and to be employed on a part-time basis. Workers falling into one or more of these categories account for over 90% of all non-covered workers.

Workers in small firms. Almost 40% of the private wage and salary labor force, or approximately 40 million workers, are employed in firms with fewer than 100 employees. The coverage rate of workers in these small firms is only 20% compared to 66% among workers in firms with 1,000 or more employees. The low coverage rate results primarily from the lack of plan sponsorship among small firms.

Low wage workers. Only 24% of workers earning less than $20,000 annually participate in a pension plan compared to 68% of workers earning $30,000 or more annually. About 55% of low wage workers are employed by firms that do not offer pension plans. Over 20% of all low income workers are in firms that offer a 401(k) plans. Less that half of low income workers offered a 401(k) plan participate in the plan, compared to 85% of higher income workers.

Young workers. In 1993 only 24% of workers under age 30 participated in a pension plan, a decrease from 29% in 1979. Much of this drop has resulted from the shift toward 401(k) plans. With 401(k) plans now commonplace, less than half of workers under age 30 who are offered a 401(k) plan are choosing to enroll in the plan. If all young workers offered a 401(k) plan choose to participate, the overall coverage rate for workers under 30 would increase from 24% to 31%.

Low tenure workers. About one-fifth of all workers have less than one year of tenure with their current employer. Only 9% of these low tenure employees have pension coverage. Only 37% of low tenure workers are employed by firms with pension plans. Even among firms sponsoring plans, however, less than one-quarter of low tenure workers receive coverage. Among the non-participants in firms with plans, about 40% fail to meet the age and/or service requirements, while an additional 12% choose not to participate in the plan.

Part-Time Workers. Only 12% of part-time workers in the private sector receive pension coverage compared to 50% of full-time workers. About 63% of part-time workers are employed by firms that do not sponsor pension plans. Of the remaining 37%, less than one-third participate. Most are excluded because of plan provisions requiring employees to work a minimum number of hours annually (generally 1,000) to be eligible to participate.

Strikingly absent from these categories of noncovered workers are women. The truth of the matter is, however, that women find themselves disproportionately represented in all these categories. Many have lower earnings than men and are more likely to work part-time and tend to move in and out of the workforce to care for children and aging relatives. Women are also often employed in industries with low or no pension coverage. Thus, women are less likely to receive pension benefits and when they do, because their pay is less and they may have less time in the workforce, their pension payments will be lower.

TRENDS IN COVERAGE

The most significant trend in the employment-based private pension system over the past 20 years has been the increasing importance of defined contribution plans. The number of participants in these plans has grown from fewer than 12 million in 1975 to 48 million in 1995. Over three-fourths of all pension covered workers are now enrolled in either a primary or supplemental defined contribution plan. Assets held by these plans increased from $74 billion in 1975 to over $2 trillion today.

It would be misleading, however, to attribute the increasing importance of these plans to the demise of the more traditional defined benefit plans. While many small defined benefit plans have terminated in recent years, large companies are maintaining their plans. From 1985 to 1995, the number of defined benefit plans with 1,000 or more participants decreased only slightly from 5,226 to 5,019, while the number of plans with 10,000 or more participants increased from 552 to 664.

Essentially all of the new pension coverage has been in defined contribution plans. Nearly all new businesses establishing pension plans are choosing to adopt defined contribution plans, specifically 401(k) plans. In addition, most large employers with existing defined benefit plans have adopted 401(k)'s and other types of defined contribution plans to provide supplemental coverage for their workers. We are also employers changing from traditional defined benefit plans to hybrid arrangements such as cash balance plans.

Although not as significant as the above two factors in the growth of defined contribution plan participants, there is evidence that some employers are replacing defined benefit plans with 401(k) plans. A study conducted for the Department of Labor found that over the 1985–1992 period about four to five percent of defined benefit plan participants in 1985 were in plans which were terminated and replaced by 401(k) plans.[1] This represents about 10% of the increase in the number of active participants in 401(k) plans from 1985 to 1992.

This change in the pension system is a reflection of fundamental changes in the economy as well as the current preferences of workers and employers. The movement from a manufacturing-based to a service-based economy, the growth in the number of families with two wage earners, the increase in the number of part-time and temporary workers in the economy, and the increased mobility of many workers has led to changes in the needs and interests of both employers and workers.

Employer preferences have similarly changed. The increased competition and volatility of a global economy has made many reluctant to undertake the long term financial commitment to a defined benefit plan. Many employers perceive defined contribution plans to be advantageous and there are indications of workers embracing the idea of having more direct control over decisions about the amount of contributions to make and how to invest their pension accounts.

PENSION SECURITY

The most important thing we can do to improve the retirement income system is to make sure that it is as secure as possible. Last year, either through voluntary compliance or civil litigation, we secured monetary recoveries to employee benefit plans of nearly $273 million. In addition, our enforcement actions in criminal cases resulted in the restoration of $6.7 million to plans and the indictment of 98 individuals for fraud related to employee benefit plans.

We have initiated enforcement efforts to assure that workers' contributions are promptly forwarded to their plans and are monitoring whether some plans are paying excessive fees. This project was initiated in early 1995 and is ongoing. From the inception of this project through the end of December 1998, we have opened a total of 3,746 investigations of 401(k) and recovered $57.9 million for 401(k) plan participants including $4.8 million from the Pension Payback Program. We have also opened 389 health plan employee contribution cases and recovered $11 million. Included in these numbers are 126 criminal 401(k) investigations, resulting in the criminal prosecution of a total of 62 persons. This project has focused the attention of the American public on the importance of retirement security.

We have issued regulations clarifying that contributions must be promptly forwarded to the plan when they are withheld from pay. This has enhanced the retirement income security of workers in 401(k) plans. In addition, the agency is currently developing a regulation focussed specifically on enhancing the security of participants in small plans by giving workers better ways to make sure that the assets that are supposed to be in their pension plans are in fact there. Moreover, during FY 1998, PWBA held a public hearing to obtain comments and data regarding fees and expenses charged to 401(k) plans, the availability of information on this topic and the extent to which plan sponsors and participants consider such information. Following the hearing, we worked on a number of initiatives relating to 401(k) plan fees, as well as released an educational booklet for participants entitled A Look at

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[1] Papke, L.E. "Does 401(k) Introduction Affect Defined Benefit Plans," Study conducted under contract with the Pension and Welfare Benefits Administration, 1996.

401(k) Plan Fees and made publicly available the results of recent research in the Study on 401(k) Plan Fees Expenses. If contributions are delayed or excessive fees are paid, worker's 401(k) plan returns will be reduced. And more importantly, worker confidence in our retirement system will be eroded.

Mr. Chairman, the President has sought to enhance pension security by proposing better audits and faster reporting of possible criminal conduct affecting employee benefit plans. Plan administrators and auditors are critical to maintaining the security of assets held by pension plans. Yet under current law, even if a significant problem is discovered, there is no requirement to report the problem until the plan's annual report is filed—frequently more than a year after the event took place. Furthermore, some audits are limited in scope under ERISA. The President has called for the enactment of legislation to respond to these inadequacies in current auditing practice, to strengthen the plan audit process and to deter abusive practices. He calls for modifying the use of limited scope audits to those situations where we can have more confidence that the plan assets are adequately protected and repealing it elsewhere, requiring the direct reporting of irregularities discovered during audits, and requiring external quality control reviews of auditors and continuing education requirements to help assure competent professionals are performing audits of plan assets.

Another measure that will enhance pension security is our proposal to give the Secretary of Labor the authority to exercise some discretion in assessing a 20% penalty for a breach of fiduciary duty involving a pension plan. The current mandatory civil penalty on fiduciaries equal to 20 % of the amount involved in the breach has had the effect of discouraging settlement of lawsuits with the Labor Department. This money goes directly to the U.S. Treasury, not to plans, participants or beneficiaries. Because this significant penalty is mandatory, it often becomes a factor in settlement discussions, and has the effect of causing money to be paid to the government when it otherwise could be used to pay benefits to the workers. This legislation would make the penalty discretionary, giving our field office personnel a much needed tool to resolve these cases.

Simplification and Flexibility

We also want to make it easier for businesses to provide retirement plans for their workers and to comply with the law. We have proposed two new initiatives to help small businesses in complying with the law. First, we have proposed a pilot project to deliver coordinated regulatory compliance assistance to small businesses in three states: New York, Pennsylvania and Ohio. A DOL compliance team will work with the Small Business Development Center, Manufacturing Partnership Center and/or Agricultural Center to provide information and training to developing, new and established small businesses. We will respond to requests for information on pension matters ranging from establishing employee benefit plans to the ERISA requirements related to administering plans. Second, we are working to develop a voluntary compliance program that will complement and enhance the agency's traditional enforcement efforts. Traditionally, PWBA conducts investigations to discover violations of the fiduciary provisions of ERISA and then seeks corrective action by notifying plans of the agency's findings and requesting plans make correction, or by pursuing litigation to compel corrections or remedies. This process has proven effective and will continue. However, from time to time, PWBA has been approached by fiduciaries who have found problems with their plans and sought the agency's assistance or approval in taking corrective action. PWBA has not had a formal process to deal with such situations. With a formal program, this type of self-initiated action by plan fiduciaries could be encouraged. Facilitating corrections by fiduciaries who want to come into compliance with the law with respect to their past practices will promote better compliance in the future. A PWBA voluntary compliance program would also benefit plan participants by getting money restored to plans quickly.

For the 1999 plan year, we intend to implement a new, streamlined Form 5500 Annual Report and electronic filing system, which will reduce costs dramatically and provide quicker, more complete access to the important information contained in the reports. We also intend to develop an Internet site on which the most recent Form 5500 Annual Reports will be available. These forms are public information, and having them on-line will make them more readily accessible to participants to enable them to readily obtain information about their plans.

Education and Information

Although the challenge of coverage expansion imposes perhaps our most formidable challenge, there are a range of other initiatives that require our attention.

The most basic of these is the need for increased information and education of workers about the retirement income system.

In July 1995, we launched a retirement savings campaign in conjunction with 65 public and private sector partners to educate American workers as to the importance of saving for retirement. Our partners have since formed the non-profit organization, the American Savings Education Council which today boasts more than 250 members. Since 1995, the Department has undertaken an ambitious campaign with activities ranging from television advertising, speeches, to preparing and distributing tens of thousands of educational brochures.

The highlight of the campaign occurred last summer when Secretary Herman kicked off the first White House National Summit on Retirement Savings. The Summit, as you know, came about through bipartisan legislation enacted in 1997 and known as SAVER Act, or "Savings are Vital to Everyone's Retirement." The Summit was attended by President Clinton, Vice President Gore, Congressional leaders and 250 delegates representing a cross-section of employers, labor unions, government, the pension industry and academia. They explored the barriers workers face when they try to save and how to eliminate those barriers. And, they talked about how we can be even more effective in spreading the retirement savings message throughout minority communities.

As part of our campaign, we have prepared, in conjunction with the Department of the Treasury, brochures and developed outreach programs, targeted to groups with historically low private pension coverage such as Hispanics, women and African Americans. For example, last fall we sponsored three talk shows on pensions, retirement savings and retirement planning on radio stations with large Hispanic radio audiences. Approximately 100 stations from Los Angeles to Houston broadcast these programs, reaching a potential of 73 percent of the United States Hispanic population. Our two most popular brochures have been translated into Spanish. We have reached out to African Americans age 25 to 65 with a news feature article and a print public service announcement that has been distributed to 140 African American newspapers. And, a broadcast news spot featuring Secretary Herman and a radio public service announcement will be distributed to 390 radio stations with large African American audiences.

We are especially proud of our efforts to reach out to women. We co-sponsored a very successful "Every Woman's Money Conference" with the Oregon State Treasurer's Office in September. The event was designed to provide women with tools to better handle issues involving money and specifically retirement savings. The event was so well received that several other States have expressed interest in hosting similar types of events. We are developing a new public service announcement which will promote our brochure entitled, "Women and Pensions: What Women Need to Know and Do."

Print and broadcast public service announcements are continuously being placed in hundreds of newspapers and radio and televisions stations across the nation. Our print ad, "Play to Retire" has done particularly well. It has been placed in over 3,000 newspapers with a potential reach of over 150 million readers. In FY 1998, we published nine new brochures and pamphlets and distributed almost 1.5 million copies of our publications. So we are vigorously spreading the saving and retirement message through a grass roots campaign across the country.

Much more needs to be done. We are building more partnerships in the small business community. We are forming an alliance with the Chamber of Commerce and the Small Business Administration (SBA) to educate small business owners about the options that are available to them for establishing a retirement savings program. We expect this partnership to pave the way for expansion of our interactive Small Business Retirement Savings Advisor and we are developing an educational video for small businesses that will augment the existing printed materials. The Department also formed a partnership with the National Association of Women Business Owners and the SBA to provide information on retirement plan options. These new brochures, "Simple Retirement Solutions" "SIMPLE," and "Simplified Employee Plans," were developed along with our interactive website to assist small employers in determining the best plan for their employees. In an effort to encourage employers to educate their workers on how to save for retirement, we issued an interpretive bulletin describing the difference between providing general investment education and providing specific investment advice. This is important, because all surveys have shown that participation in 401(k) plans increases after employers engage in worker education programs.

For the second year, we are also partnering with the Securities and Exchange Commission in the "Facts on Saving and Investing Campaign" which is intended to increase investor education. This Spring, Secretary Herman will appear on "Parenting in the 90's and Beyond," a syndicated cable program to discuss the importance of parents teaching their children about saving. And in line with their focus to educate youth about savings, the Department is developing new tools for children on the web. We will demonstrate an interactive game on the Internet that teaches children basic skills about spending and saving money they make from allowances.

We are confident that these efforts will raise the awareness of people to the need for saving for retirement. In effect, we are hoping to stimulate the worker demand for retirement savings that will lead to a more secure future for all of us.

CONCLUSION

The private pension system is an essential part of the bedrock on which the security of current and future retirees rests. For those fortunate enough to participate, the system remains vibrant and essentially secure. The challenge before all of us is to include the other half of the workforce in this American success story. Working together we can achieve that goal.

Chairman HOUGHTON. Thank you, Ms. Kramerich.

Now, Mr. Strauss.

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

Mr. STRAUSS. Mr. Chairman, Members of the subcommittee. Mr. Chairman, I am particularly pleased to appear before you because of your long record of protecting the defined benefit pension system. In 1994, in the final days of the GATT conference, when adoption of the Retirement Protection Act hung in the balance, your calls to key Republican conferees ensured passage of that vital legislation. Your work as ranking minority member of the committee at that time, helped ensure the solvency of the Federal Pension Insurance program and we are most grateful to you, Mr. Chairman, for that.

Mr. Chairman, as the Federal official who is mandated by statute to promote the continuation and maintenance of the defined benefit pension system, I am most grateful to you for inviting me to testify today on the future of defined benefit plans and retirement income security. In the five minutes that I have been allotted, I would like to share just one part of my prepared testimony with the subcommittee, which I believe cuts to the heart of the retirement income security debate.

Mr. Chairman, I believe that defined benefit plans along with Social Security are the only possible route to retirement income security for millions of middle-and lower-income Americans. I personally know how valuable defined benefit plans are from my own experience. My father was typical of many Americans nearing retirement. He had no employer-provided pension plan. He hadn't been able to save very much. And he was running out of time.

My father has spent all of his life in North Dakota. When he retired from his job as the meat cutter in a grocery store in Valley City, North Dakota, he was 63 years old and he had never had a pension. He then took a part-time minimum-wage janitor job at the local high school, but for the first time in his life, he was covered by a defined benefit pension plan. He retired a second time, 15 years later, at age 78 with a pension that now provides him with $169 a month, which is a supplement of over 20 percent of his Social Security benefits. He would have had to have saved over 15 percent of his minimum-wage salary over the entire 15 years to generate, on his own, the same benefit each month.

It is difficult for seniors like my mother and father to live on Social Security alone, so my father's pension makes a real difference. $169 a month has real purchasing power in Valley City, North Dakota. My dad doesn't have to worry about running out of money. For as long as he lives, he is going to get a monthly check and he can spend it all each month and not worry because he knows the next month, he will get another check. He doesn't have to worry about how much he can afford to take out of his savings each month or what the market will do. His pension is not dependent on his investing skill or his investing luck. Plus, if my father dies before my mother, the pension plan will provide her with a survivor benefit for the remainder of her life. You can't put a value on the peace of mind that this guaranteed income for life gives people like my father and mother or, for that matter, their children.

Mr. Chairman, there are several morals to my father's story. First, a worker is never too old for a defined benefit pension plan. Second, a defined benefit plan can make a great deal of difference, even for workers making very modest incomes. And, third, you can never underestimate the value of even small amounts of guaranteed income for life that can never be taken away.

Mr. Chairman, despite the value of defined benefit plans, the system is in trouble. The number of plans insured by the PBGC has decreased from 114,000 in 1985 to 44,000 today. Few new plans are being created and few new participants are coming into the system. And the number of nonactive participants in defined benefit plans will soon exceed the number of active workers. In the face of these alarming trends, I asked a PBGC team to conduct an exhaustive review of the defined benefit system to determine how to make defined benefit pension plans more attractive to both employers and workers.

During the last year, we made a special effort to consult with and listen to a broad cross-section of our stakeholders, including plan sponsors, pension practitioners, unions, and other organizations representing the interests of participants. Recognizing the reality that pension plans are sold, not bought, we especially sought out those pension experts who make their living marketing pension plans. We literally talked with hundreds of these people to find out what could be done to make defined benefit plans more attractive.

Mr. Chairman, we look forward to sharing what we learned with the subcommittee and working with you to strengthen the existing defined benefits system and to expand it to provide benefits to more rank-and-file workers. I thank you again for allowing me to testify today and I look forward to answering your questions. Thank you.

[The prepared statement follows:]

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

Mr. Chairman and Members of the Subcommittee: Good afternoon. I am David Strauss, Executive Director of the Pension Benefit Guaranty Corporation (PBGC). PBGC was created as a federal corporation by the Employee Retirement Income Security Act of 1974 (ERISA). We protect the pensions of about 42 million workers and retirees in about 44,000 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. Both of these pension programs are in sound financial condition. The promised defined benefit pensions that PBGC guarantees are secure. The multiemployer program has been in surplus since 1980, and we have registered significant accounting surpluses in the single-employer program for the last two years. We soon expect to report surpluses for both programs for FY 1998. Despite these surpluses, however, we need to remain vigilant. As a recent GAO report on PBGC's financial condition stated, "An economic downturn and the termination of a few plans with large unfunded liabilities could quickly reduce or eliminate PBGC's surplus."

I want to thank you, Mr. 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. I appreciate the opportunity to appear before you today to speak about national retirement policy. As the federal official who is mandated by statute to encourage the continuation and maintenance of defined benefit pension plans, I also appreciate the opportunity to explain the importance of defined benefit pension plans for the retirement security of America's workers.

As the President indicated in his State of the Union message, an adequate retirement continues to depend on all three legs of the retirement stool—Social Security, personal savings, and private pension plans. Addressing the first two legs of the stool, the President has put forward significant Social Security reform and universal savings proposals, proposals that are particularly important for middle and lower income Americans.

Today's hearing addresses the third leg of the retirement policy stool—employer-sponsored pension plans. Revitalizing the private pension system is an essential and complementary ingredient in achieving retirement income security for all Americans. I believe that defined benefit plans are critical to the private pension leg of the stool, especially for middle and lower income workers. That is because they are the only private retirement vehicle that can reliably provide predictable, secure benefits for life.

Challenge of Retirement Income Security

The challenge of providing retirement income security for the baby boom generation and others nearing retirement is one of the biggest domestic policy challenges facing our country. There are a huge number of people affected:

- 25 million are aged 53 to 62, and close to the end of their working careers;
- Right behind them are 78 million baby boomers, a quarter of whom [18 million] are already at least 48.

Surveys have shown that Americans want to retire at younger and younger ages. When you ask average Americans what they consider the optimum retirement age, the answer they give is 54. If you think 54 is young, one survey shows that 64% of college students want to retire by age 50!

A gap obviously exists between the dream of early retirement and reality. And, for more and more people, it's becoming a serious worry. A USA Today survey found that next to cancer and car wrecks, Americans now worry most about retirement income security.

Inadequate Savings

People are worried because they know they have not been saving enough, early enough in life, to meet their retirement needs. Last year the *personal savings rate* fell to the lowest level since the depths of the Great Depression. Americans continue to spend almost all of their current income. Some *45 percent* of American families now spend more than they earn.

- Many *low income workers* have *no* savings at all.
- The same holds true for *many better-paid workers* who, because of more immediate needs like housing and education, do not begin to save for retirement early enough in their working careers.
- Most *older workers* haven't saved much either: Half of America's households headed by people between the ages of 55 and 64 have wealth of less than $92,000—and most of that is equity in their homes.

Even workers with 401(k) plans aren't saving enough. An Employee Benefit Research Institute study of almost seven million 401(k) participants shows that:

- The average 401(k) account balance is only $37,000;
- And the median 401(k) account balance is less than $12,000; in other words, half of all 401(k) accounts have less than $12,000 in them.

EMPLOYER-SPONSORED PENSION PLANS

Not only are workers not saving enough on their own, but:

- Less than *50 percent* of the private-sector workforce is covered by any employer-sponsored retirement plan;
- In small business it's even worse—it's only *20 percent*;
- And among low-wage workers (annual wages under $10,000), it's even more serious—*only 8 percent* have any sort of plan.

THE NEED FOR DEFINED BENEFIT PLANS

- So, we live in a world where people aren't saving enough;
- Where millions have inadequate pension coverage;
- And where people are worried because they realize time is running out.

MY FATHER'S STORY

As I said earlier, I believe that defined benefit plans have a critical role to play in securing retirement security for millions of Americans. I *personally* know how *valuable* defined benefit plans are from *my own* experience. My father, who turned 89 this month, has spent all of his life in North Dakota. He 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 an 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. When he retired a second time 15 years later, he was making $6.25 an hour.

The pension my father earned during those 15 years now provides him with $169 a month—a supplement of over 20% to his Social Security benefit. He would have had to save at more than 15% of his salary over the entire 15 years to generate on his own the same benefit each month.

It is difficult for seniors like my mother and father to live on Social Security alone. So my father's pension makes a *real* difference:

—$169 a month has real purchasing power in Valley City, ND.

—My Dad doesn't have to worry about running out of money.

—For as long as he lives, he's going to get a monthly check. And, he can spend it and not worry.

—Plus, if my father dies before my mother, the pension plan will provide *her* with a survivor benefit for the remainder of her life.

—You can't put a value on the peace of mind that this guaranteed income for life gives people like my mother and father or, for that matter, their children.

There are several morals to my father's story:

- First, a worker is never too old to gain from a defined benefit plan.
- Second, a defined benefit plan *can* make a *great deal* of difference *even* for workers making very modest salaries.
- And, third, you can never underestimate the value of even small amounts of guaranteed income for life.

DEFINED BENEFIT SYSTEM IN TROUBLE

Despite the value of defined benefit plans, the defined benefit system is in trouble:

- The number of plans insured by PBGC has decreased from 114,000 in 1985 to 44,000 today, most of the decrease being in the small business sector;
- The percentage of American workers with pensions whose *primary* pension is a defined benefit plan has dropped from 83 percent in 1979 to 50 percent in 1996;
- There are few *new* plans being created;
- There are few *new* participants coming into the system;
- And the number of non-active participants in defined benefit plans will soon exceed the number of active workers.

PBGC'S RESPONSE

In the face of these alarming trends and as part of the Administration's continuing efforts for retirement security, I asked a PBGC team to examine the system and find out what would make defined benefit plans more attractive to employers and workers. During the past year we made a special effort to consult with a broad cross-section of our customers—employers, pension practitioners, and unions and other organizations representing the interests of participants.

Recognizing the reality that pension plans are sold, not bought, we especially sought out those pension experts who make their living marketing pension plans. We literally talked with hundreds of people to find out what can be done to make defined benefit plans more attractive. We have received a lot of good ideas to strengthen and expand the defined benefit system and we are working to develop them.

ADMINISTRATION STEPS

In addition to these exploratory efforts by the PBGC, the President's budget includes a package of initiatives designed to enhance retirement security by:

- Expanding pension benefit coverage;
- Increasing the portability of pension benefits;
- Strengthening women's retirement security;
- Expanding workers' right to know;
- And strengthening the security of workers' retirement savings.

Many of these proposals have also been introduced in the Congress on a bipartisan basis. The Department of the Treasury is addressing these proposals in their prepared testimony, so I just want to say a few words about several that are of particular interest to the PBGC.

First, we have proposed a simplified defined benefit plan for small businesses—the SMART. And various Members of Congress have introduced a similar proposal called SAFE.

Both SMART and SAFE remove some of the major obstacles to small business defined benefit plans. They also combine some of the best features of both defined benefit and defined contribution plans. Under the proposals:

- 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 made more understandable to workers;
- Older workers would get the chance to earn a meaningful benefit even if they were not previously covered by a plan;
- Benefits would be provided to lower-wage workers who would have difficulty making contributions;
- And benefits would be 100% vested at all times as well as portable.

In addition to the simplified small business defined benefit plan, the President's budget includes other PBGC-related incentives for new plans:

- We would reduce PBGC premiums to $5 per participant (and eliminate the variable rate premium) for new small business plans, including most SMART plans (which would also be insured by the PBGC);
- We would phase-in the variable rate premium for new middle-sized and large employer plans;
- And we would increase the PBGC benefit guarantee for small business owners so that most will receive the same benefits as other workers if their plans terminate.

The budget submission also includes two other proposals affecting the PBGC:

- The maximum guaranteed benefit for a participant in a multiemployer plan, which has not increased since 1980, would be adjusted by a one-time inflation increase. (For a retiree with 30 years of service, the maximum would increase to $12,870 from $5,850.)
- And, as a service to the plan community, PBGC's missing participants program would be expanded to other terminating plans—multiemployer defined benefit plans, defined contribution plans and defined benefit plans not covered by PBGC (such as plans of small professional service employers).

We look forward to working with you on a bi-partisan basis as we did in enacting pension reform through the RPA in 1994 and the SIMPLE in 1996. 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.

Chairman HOUGHTON. Thank you very much, Mr. Strauss.

I am going to pass over to Mr. Coyne, and then we will go orderly back and forth. But before I do, maybe you could just elaborate a little bit on this review to strengthen defined benefit plans. Who did you talk to? What did you do? Just sort of give us a little essence of what happened.

Mr. STRAUSS. Mr. Chairman, as you know, before I came to the PBGC about two years ago, I was the Deputy Chief of Staff for the Vice President of the United States. And in that capacity, I heard his reinventing government speech probably more than any other human being alive today. And rule number one for reinventing government was indelibly etched in my psyche, which is to identify your customers and win them over. So if you're the Vice President's guy running the Pension Benefit Guaranty Corporation and you don't have a pretty good concept of reinventing government, you are probably going to be in real trouble.

And so what we did is attempt to survey the level of satisfaction with the existing defined benefit system with, two focuses in mind. One, what needed to be done to preserve the existing system, because, over time, about 75,000 plan sponsors have walked. And then, secondly, what to do to make plans more attractive to create interest in DB plans.

We literally talked to hundreds of stakeholders and we talked to everyone from the plan sponsors and all the groups who represent the plan sponsors at one end of the spectrum to all the participant groups and their representatives at the other, and, literally, everyone in between. And what was interesting is that there is a consensus among all of these stakeholders about the issues that we really need to focus on and I can boil those issues down into three areas.

The first area that we need to focus on is the whole area of incentives and the need to look at the incentives that were contemplated when ERISA was passed that made it attractive for the business owners and the top executives to get their benefits from the same plans as the workers. Over time, those incentives have been eroded and, in more and more situations, the business owners and the high-paid executives are now getting their benefits from nonqualified plans and they no longer feel a stake in the workers' pension plans.

The second area that we were told that we really need to focus on is the whole area of flexibility, the need to give employers the flexibility to meet the needs of the modern work force—what employers are looking for. They are looking for the flexibility to meet the needs of their younger workers who are more interested in portability and having an individual account, but also the needs of their older workers who are more interested in the traditional defined benefit plan.

And the third area that we were told to focus on is the whole area of complexity—that when you look at any rule it might make sense in and of itself, but when you take the cumulative effect of all of these rules, the weight of all of these rules is having a very adverse impact on the system.

So our findings pretty much fall into those three areas.

Chairman HOUGHTON. Well that's very helpful, thanks very much.

Mr. COYNE. Thank you, Mr. Chairman. Secretary Lubick, what can be done legislatively to help workers who are living paycheck to paycheck prepare for their retirement?

Mr. LUBICK. Mr. Coyne, I think that we have made a number of proposals that are contained in the bill of which you are a cosponsor, introduced by Mr. Neal, to make it easier and simpler for their employers to provide coverage: A simplified, defined benefit-type plan for small business, which, I think, certainly goes a long way toward what Mr. Strauss mentioned. A small business tax credit to make it not expensive for the employer to set up a plan. Direct payroll deduction for IRAs. Better portability.

But I would say another thing that is very important, which we will be able to talk to you about in the upcoming weeks, is the President's USA plan, which will provide a tax credit, an automatic tax credit, to be credited to an account for the lowest-paid workers so they will have something that is saving, represents saving for them and it will grow and then there will be, on top of that, credits to match contributions that they make. And we hope that this plan will be a tremendous boost to enable those who have difficulty in affording it to increase their savings.

Of course, best of all is to keep the economy going in a way that these workers can benefit from jobs and earnings. But, beyond that, I think the combination of both making the private pension system more accessible and increasing personal savings through systems such as that provided by USA will go a long way toward meeting that goal. It is not an easy goal.

Mr. COYNE. So the administration and Treasury are not opposed to incentives to make pensions more readily available to workers?

Mr. LUBICK. Well, we quite agree with the Congress and all of you that, if incentives are necessary, we want to make sure, in the interests of fiscal discipline that they are wisely spent and that they are going to be productive of the result which we are looking for. And we think that the persons that have the most difficulty and are in the most need of this are the lowest-paid and the moderate-income taxpayers. And, to that end, the system is designed to give incentives to the highly paid on the theory that they will be motivated to provide for the rank-and-file employees as well, on a nondiscriminatory basis. I think that concept has always been fundamentally sound and needs to be encouraged.

Mr. COYNE. Thank you. Thank you.

Chairman HOUGHTON. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I am encouraged by what Mr. Lubick said at the end that that concept is fundamentally sound and needs to be encouraged. I would argue the last couple of decades what we have done is just the opposite. We have begun to reduce those incentives and why don't we go back to what we thought worked originally which is this fundamentally sound concept of adding more incentives.

I wasn't going to raise it, but you raised the USA account and I can tell you, it scares me to death and I hope you all are doing some analysis down at the Treasury as to the impact of USA accounts on the private pension system. I think to take away this private leverage that we have in the pension system by putting USA Accounts in place, where most low-paid workers, as I look at it, would be better off in a USA account than any kind of a private pension system that is out there, practically. As Mr. Strauss says, it is increasingly a defined-contribution world. You are going to knock out the 401(k)'s and other private pension plans because people are not going to be able to meet the non-discrimination test that you talked about earlier being so important.

So I don't want to get into a long discussion of this today because we have these other bills to talk about, but I just hope that Treasury is looking carefully at the EBRI analysis that I have seen, and other analysis out there. And just common sense tells us that to have the Government step in and provide a more attractive offer with taxpayer money might be undercutting the very thing that all of us want to encourage, which is the private sector to step in to provide more and, as Mrs. Kramerich said so well, expanding the attractiveness of pension plans, the need for all boats to rise by having everybody have a boat, which I think should be the objective instead.

Mr. LUBICK. We have been aware of that possibility from day one. And the plan has been designed, as I say, to complement and not compete with the private pension plans. But I don't want to steal the President's thunder and lose my job. So in the next few weeks, I hope, we will be able to discuss this with the same knowledge, each of us.

Mr. PORTMAN. We look forward to hearing the thunder, but again I have to say I am very skeptical as one member. And this is not a partisan issue. I think it is great the President is talking about personal accounts. I think it is great he is talking about expanding retirement. But let's not do it by destroying the very system we are all trying to build up. When you have half the people in America without pensions, then put in a place a plan that could drive the rest of the private system out of business, it seems to me to be the wrong say to go. Rather, let's try to build up what we have—go back to, as you say, that fundamentally sound concept.

Having said that, I also just have to add that, just listening to you all today and listening to Mr. Strauss and you, I see different perspectives. And I think Treasury, sometimes, as I wrote it down when you were talking, focuses on who gets the tax benefit, and looking at your testimony. And again, I am more encouraged by what you have said in response to the question, but who gets the tax benefit is a very interesting question.

The fundamental question has to be who gets the pension benefit. And I think that is what Mr. Strauss is focused on. And I would just respectfully submit that that ought to be the focus of all of our efforts—you know, who is going to get more pensions, not being too focused on what obviously hasn't worked in the past, which is the status quo focused on tax benefits.

Mr. LUBICK. I think we agree on that, Mr. Portman. I think when I said the benefits, who gets the benefits, I meant not just the benefits of the tax reduction but it is the result that counts. And we are perfectly willing, in fact encourage, the expenditure of tax monies provided the result is the increased coverage. I think you and I are exactly in accord in stating the problem.

And I think it then becomes a question of evaluation of what is the tax cost and what are the amount of benefits that are going to be produced.

And reasonable people can certainly differ.

Mr. PORTMAN. I couldn't agree with you more. And I think that is the discussion that I have. Just again, looking at your written statement, hearing your oral statement, I got a different impression. It is a matter of focus, and there are some legitimate differences of opinion here. But I think if we focus exclusively on the tax-benefit side and, as you say in your statement, distribution tables. And so on, we are going to lose track of where we are really at here.

And what I think, again, Mr. Strauss was saying is, let's focus on, as he said, incentives for decision-makers, business owners and executives, put these plans in place, flexibility to meet the needs of an increasingly mobile workforce, complexity, and the cumulative effect of that complexity.

On the similarity front, there are a lot of similarities between your proposal, which was introduced today by Mr. Neal, and the proposal that Mr. Cardin and I have been working on for over two years now with a lot of folks at this table. And I see accelerated vesting in there, the small-business tax credit—we picked up your language on that because we think that could be helpful—the relief from some of the PBGC variable rate premiums for new defined-benefit plans, the PBGC flat premium relief for new small-business defined-benefit plans, eliminating the 100 percent of compensation limits under 415 for multiemployer plans that Jerry Weller has been so involved in, the rollover and consolidation, the portability provisions—there are a number of those in here that I see are similar, if not identical, including the TAMRA full-funding repeal, which I think is very important.

So I think, Mr. Chairman, I don't want to leave the impression that there is a big difference. In fact, I would say that more than half of the bill that, again, we have worked on the last couple of years with a lot of folks in this room, including with Treasury, is similar. And maybe more than half of it is either similar to or identical to what Treasury has sent up. We have some things they don't have; they have some things we don't have.

But I think we are at a point where we can work together. I would just hope we can get beyond this notion that we can't do anything to shake up the tax side of this because if we don't, we are going to end up with fewer people covered, and maybe feel better about ourselves, but not have the impact or the effect that Mr. Strauss talked about.

By the way, I am changing my opinion about reinventing Government, having heard from Mr. Strauss. [Laughter.]

Thank you, Mr. Chairman.

Chairman HOUGHTON. Well, thanks very much. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. Mr. Lubick, you made reference earlier in your opening statement to the notion about half the American workers do not have pension plans. Who are these people?

Mr. LUBICK. Well——

Mr. NEAL. What are their work characteristics?

Mr. LUBICK. By and large, they are the lowest-paid or the employees of small businesses that find it either too difficult or too expensive to set up plans for their workers or women who move in and out of the workforce. So I think the persons who are not sharing in this primarily are those that are probably in the most need.

Mr. NEAL. What happens to them in retirement?

Mr. LUBICK. They would face the problem that Mr. Strauss' father would have faced if he didn't get that janitor's job and get that pension. They would be very hard-pressed if they had a medical emergency. They would probably have to depend upon charity for help. They would be hand-to-mouth from Social Security check to Social Security check.

Mr. NEAL. Mr. Strauss, why do you no longer list the top 50 of under-funded pension plans?

Mr. STRAUSS. After the RPA legislation was passed in 1994, where disclosure was provided to every participant in a plan that was not at least 90 percent funded, a blunt tool like the top-50 list was no longer needed.

Mr. NEAL. How do they discover that their plan is under-funded?

Mr. STRAUSS. Well, from the reporting. If a plan if less than 90-percent funded, then there is a special PBGC model notice that goes out to each participant in the plan that explains what would happen in the event that the plan would terminate, what the PBGC benefit would be. And so, Mr. Kleczka is very familiar with this particular provision, and it has worked extremely well.

Interestingly enough, plans have not had to use it all that often. Now it sort of exists as a hammer.

Mr. NEAL. Thank you. Thanks, Mr. Chairman.

Chairman HOUGHTON. Thank you very much. Mr. Weller.

Mr. WELLER. Thank you, Mr. Chairman. And Mr. Secretary, it is good to see you again. And I am really welcoming the tone of this meeting, which clearly states that retirement security is and should be bipartisan priority. And pleased that it is a priority and very much on the agenda of this Congress as well as on the agenda of the administration.

The question I would like to focus on, and Representative Portman made reference to our efforts on an issue that I believe there is bipartisan concern about as well, and that is the issue of the Section 415 limits on compensation-based limits and dollar limits that were placed along time ago on multi-employer pension funds.

And this is an issue that first came to my attention a number of years ago, usually by a spouse who discovers after her husband is getting up at 6 o'clock in the morning and putting in a lot of years, going out finishing cement, or is a plumber or helping build a highway, that after all those years of extra hours and overtime and, particularly in good times like we have right now in construction, that they are a little surprised when they find out what they are going to get in their pension benefits out of their multi-employer pension fund.

Question I have, and I think perhaps it might be most appropriate to direct to the Department of Labor, is, I was wondering, is there any reason to continue these Section 415 compensation-based limits and dollar limits on multi-employer pension funds?

Ms. KRAMERICH. We are talking a percentage of compensation and the actual dollar limit of $130,000. I believe, let me confirm with my colleagues, we have a proposal changing that.

Mr. LUBICK. We—Mr. Weller, I think all of us, share the view that that rule is both difficult to apply and inappropriately low in many circumstances. If a worker is in a multiemployer plan and is working for a number of different employers during a given year, it is a complication to require aggregation. They are usually not pay-based like many pensions are, as a percentage of compensation.

And the pay of those workers is very volatile. So we think it is inappropriate to have the 100 percent of average pay limit in the multiemployer situation. It is very different.

Mr. WELLER. Sure. I think as you pointed out, of course, for a lot of building tradesmen, for a lot of construction workers that may work for a half a dozen different contractors in the same week sometimes——

Mr. LUBICK. Right.

Mr. WELLER. But is there any reason any of these changes might jeopardize the pension fund? Is there any reason to keep those in place?

Mr. LUBICK. The contributions to those funds from my experience are generally based on cents-per-hour worked, and I don't there is any particular jeopardy because the funding is designed to provide——

Mr. WELLER. If I may reclaim my time, does the Department of Labor have anything?

Ms. KRAMERICH. Yes. Thank you, Congressman. And I appreciate my colleague's more-than-able assistance and bail out there. [Laughter.]

We did propose the change. The administration proposed it many times in a number of bills that included that particular proposal. And, you are right, for workers in multiemployer plans, they are often changing jobs and a compensation limit is going to cap them at a level that is just far too low to provide them with an adequate benefit.

I have not worked for the Vice President. I have worked for Mr. Strauss at the PBGC, and I believe they have studied extensively the fact that increasing the limit would not be a threat to the funding of multiemployer plans or the PBGC's ability to guarantee those plans, so I think it is an important change.

Mr. WELLER. We have had bipartisan legislation in the previous Congress which will be introducing later this week which we welcome working with you on.

So, thank you.

Chairman HOUGHTON. All right. Thanks very much. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman. Secretary Lubick, I first want to agree with Mr. Weller. I appreciate very much the tone of your presentation here and that we are all working together here to try to improve retirement security for all Americans. I also share your concern for moderate- and lower-income workers as we look at any change in our pension system to make sure that we improve the circumstances, particularly for moderate- and lower-income workers.

But I would just make one observation. It seems to me that our current system has had the impact of hurting lower-and moderate-income workers because, as you have responded to a question, they are the ones who don't have adequate coverage today. So if the system was working well, these tests were doing everything it should, the incentives were there that were needed, seems to me that we would have a better performance today than, in fact, the record reflects.

Mr. Strauss, if I could impose upon you, you gave a—you have done a survey, you know why we don't have as many defined-benefit plans out there, at least why people are saying we do not. You gave three categories of areas of concern. I was hoping you could be a little more specific.

In your first area, where you were indicating that employers are not setting up these plans because they don't have a stake in the plan, they don't think they would, how would compensation-limit adjustments or being able to provide a richer benefit plan deal with those types of concerns, such as the way it has been proposed in H.R. 1102?

Mr. STRAUSS. When you look at the benefit limits, for example, and you look at the benefit limit that was originally contemplated at the time of ERISA for an employer who is age 55—when ERISA was passed in 1974—for an employer at age 55, the benefit limit was $75,000. Now, 25 years later, the benefit limit for that same employer is $65,000. So over 25 years, it has actually been reduced by $10,000.

So when you look at the real dollar impact of that, it is worth about a fourth of what it was at the time that ERISA was passed. And to the extent that these incentives have never been adjusted for inflation, the business owners and high-paid executives no longer feel any stake in the workers' pension plan. They don't feel that they have any connection to that anymore. And they now look at non-qualified plans as a way of getting their benefits.

And so, the advice that we got, interestingly enough—we got this advice from all of the people that we surveyed across the entire spectrum—really, the first issue that we need to address, if we are serious about revitalizing the DB system, is that we have to make the business owners and the high-paid executives feel that they have a stake in the workers' pension plans again.

Mr. CARDIN. That is helpful. I think that answers that question.

Mr. LUBICK. Mr. Cardin, could I add something?

Mr. CARDIN. Sure.

Mr. LUBICK. I mean I can't say that $160,000 of considered compensation, which is the limit today, indexed for inflation, is going to be less or more of an incentive than $159,000 or $161,000—there is a matter of judgment involved here—or $200,000. I can't scientifically determine what is the right amount.

But I think what we have to consider, and this is what I was referring to in my discussion with Mr. Portman, is that if we make a change, we have to have at least some evidence that it is going to produce the incentives.

Mr. CARDIN. I guess my point is that we know what the current system has produced, particularly in defined-benefits plans, so we know that there is a problem, a serious problem. And, although $160,000 may seem like a lot, when you look at projected income, it certainly affects workers who have much lower income than $160,000. So I think the fear factor, by mentioning these high numbers, has done a disservice to this issued.

Mr. LUBICK. I think another factor is, 401(k)—in 1978, Mr. Chairman, I was part of a group with your predecessor from Alexander, New York, that solved the cash or deferred problem, which instituted 401(k) plans. And you are now finding, and I think Mr. Strauss would probably share his opinion with me, that the popularity for employers of 401(k) plans is a factor that had led people away from defined-benefit plans.

Mr. CARDIN. Well, it may well be, and I want to get back to defined-benefit plans. But Mr. Strauss, just one more thing, you mentioned the complexity issues. These are some of the questions that we will talk about later. But how about top-heavy rules? Do they come out as one of the issues that are frequently mentioned by companies that you surveyed as a concern on the complexity issues?

Mr. STRAUSS. The top-heavy rules are certainly an issue that is frequently mentioned. And what I might say about that is that our concern here is that we are all for simplification as long as that simplification results in benefits flowing to rank-and-file workers. And so there are a number of these provisions that are questioned, and when you hold them up to the light, there might be all sorts of problems with them.

At the end of the day, we have to make sure that the benefits flow to the rank-and-file workers. So we have to get the relationship between the incentives and the benefits right so it has the desired effect so people like my dad end up getting a pension.

Mr. CARDIN. We agree with you completely. And we want to make sure that if there are any proposals that we are making, that you believe could cause some problems, please come back and let us know.

Mr. STRAUSS. Thank you.

Chairman HOUGHTON. Next gentleman is Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman. Mr. Lubick, between 1982 and 1994, Congress passed 10 budget and tax acts which raised—$45 billion in revenue by making changes in the tax treatment of qualified pension plans, whether it reduced contribution and benefit levels, whether it curtailed interest rate assumptions, restricted funding levels and the like. And everybody has talked about, lamented the fact, that we now have a very complicated system.

I know you find this hard to believe, some people believe that those changes, between 1982 and 1994, were simply enacted to raise revenue, to either pay down the deficit, or perhaps to pay for other revenue-losing proposals in the budget. Do you share this view regarding the motivation behind those pension changes between 1982 and 1994?

Mr. LUBICK. I believe the legislative history points otherwise. Obviously, it raised revenue, and revenue is always a consideration in this committee. I was not a participant during those times——

Mr. HULSHOF. And that should be noted for the record. [Laughter.]

Well, let me ask you, has the cumulative effect been to make it more or less favorable for a business owner to establish a qualified retirement plan?

Mr. LUBICK. I don't think anyone can gainsay that a business owner who can get a greater benefit is going to have a greater incentive to establish the plan. It stands to reason.

I spent the first 11 years of my professional life representing business owners in setting up these plans, and I will state that, not always, but in many, many cases, the objective of the owner was to get as large a pension as he could at as a little cost to the business as was possible. And that led me to be quite an expert on how to provide benefits for the highly paid without doing very much for the rank-and-file.

But the premise of all of this is that the self-interest of the highest paid should be the inducement to bring the rank and file in. I think you need some protection to make sure that inducement is carried out.

Mr. HULSHOF. Let me, again, we are under the gun on time. Let me ask this last question. Maybe it is more of a comment. I'll see if there is a question mark on the end.

On page 4 of your oral testimony today, you talk about this President's preference to make improvements investing in annuity options to enhance retirement security for women. I have gone to your written testimony on page 9 and 10 and agree with you regarding women's lower pension benefits than men, and as far as the percentage, whether it's pensions are typically smaller of women than men.

You talk about FMLA. I think Mr. Portman's and Mr. Cardin's bill, and Mr. Neal and others have included that perhaps, a credit for that, regarding vesting in eligibility. You also talk about the 75 percent joint survivor annuity to help women in retirement.

How do you square that with the administrations' insistence on taxing the buildup of annuities on those same women when they want to transfer those annuities in which they want to retire?

I find that a bit inconsistent. You share my opinion?

Mr. LUBICK. No. I guess I don't. But, are you talking about last year's proposal?

Mr. HULSHOF. Yes, sir. In fact, let me ask you. Is it now the administration's belief and position that that is no longer good public policy, that is, raising revenue by taxing the buildup of annuities because this is really a women's retirement issue.

Mr. LUBICK. Last year, we were dealing with the tax-favored treatment of annuities, which was generally a situation where you got a tax-free buildup by cloaking an investment program in the form of an annuity, and it got a special tax preference that was not available to other investment media. And the statistics, I believe, are fairly clear that this was primarily done for high-income people who are sheltering investment income from taxation that would have applied in other investment media.

I think the policy was sound. I would be glad to talk with you in private on that, and give you the evidence that we have.

Mr. HULSHOF. Well, I appreciate that offer because on this issue reasonable minds differ, and, Mr. Chairman, in light of the time, I yield back. Thank you.

Chairman HOUGHTON. Thanks very much. Yes, Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman. It is good to be back to my old subcommittee. If I had known you were going to be the chairman, I'd have given up the spot on Budget Committee to serve with you. [Laughter.]

But, nevertheless, to the panel, I want to focus on the notification issue. We did produce some changes to PBGC so employees knew when the pension plan was having a problem. My question today is for Secretary Kramerich. We had a situation in my district where a company, Louis Allis went bankrupt. And what the company did for the three months previous to filing was deduct the employees' 401(k) contributions but never remit them on to the fund company. And all along the employees saw this deduction off their check. They assumed that it was going into the fund company in their account. But that was not the case.

So today, because of the bankruptcy, the employees will never see those dollars again. My question to you is, as we talk about pension reform, and God knows we need it, what recommendation can the Department of Labor put forward that we can provide some notification to employees so in like circumstance or like situation, at least the employee would know that something awry.

The fund manager could possible be asked to notify employees, but something went wrong there, and the fund group never told the employees, and the employer naturally would tell them. And now they are high and dry.

What would you recommend that, when we talk about reforms, that we could amend one of the bills to provide some decent employee notification.

Ms. KRAMERICH. Congressman, I am familiar with the case in your district that you are talking about. I can address what general provisions might be helpful. I won't comment on the particulars of the case under investigation, but on the general issue. What we might be able to do together.

Mr. KLECZKA. OK.

Ms. KRAMERICH. The President's bill does include audit protections that would be required of large employer plans, 100 participants and over, and notice requirements so that evidence of irregularities in the handling of pension assets could trigger a notice requirement to the Labor Department. And perhaps, in certain circumstances, that would be helpful in kind of preventing the harm——

Mr. KLECZKA. Is this an annual type notice?

Ms. KRAMERICH. More frequent than annual. What it is saying, is if there is an irregularity, then the notice requirement would kick in immediately, within five business days, in the way that we have proposed this language. Notice would have to come to the Labor Department that an irregularity has been detected.

But we would need to talk about what an irregularity means and whether it would cover the kind of things that your participants have experienced. But that is one particular legislative proposal that is pending, and has been put forward.

Mr. KLECZKA. OK. The members have to vote, so I am going to be very quick. I should say that in this situation, the Department of Labor has done an excellent job in helping these employees. They did receive the back wages already. However, there are other problems.

Are there any recommendations you can share with the committee to ERISA to help in these pension enforcement problems?

Ms. KRAMERICH. If I could also tell you more for the record, I would be happy to do that about the project that we are undertaking right now to come up with protections for small plans, to improve the requirements so that assets invested in small plans would have to be disclosed by the financial entity that holds the assets to the participants on an annual basis. And notice would have to be made available so that the participants themselves would have some assurance that those assets are actually invested as they have been promised.

That too is something that we are working on right now that might be helpful in some more cases.

Mr. KLECZKA. I think that to be important.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Well, ladies and gentlemen, we have votes, as you have heard; there is one 15-minute vote, which is now about a 5-minute vote, and we have three other 5-minute votes. So, we will stand in recess and come back just as soon as we can. I am sorry for the other panelists.

So this panel is finished, and we appreciate very much your participation.

[Recess.]

Chairman HOUGHTON. All right. If we can reconvene now. We have a panel of Teresa Heinz, Robert Chambers, Daniel O'Connell, Carol Sears, and Normal Stein.

Now I am going to ask everyone to be patient and give Mr. Stein an opportunity to speak first because Mr. Stein has five children in Tuscaloosa, Alabama, and he has a wife on the West Coast; he has to get a 6 o'clock flight. Is that right?

Mr. STEIN. Seven thirty

Chairman HOUGHTON. Seven thirty. All right. Well, any way, we have a little bit of elbow room. But why don't you begin and then we will go on and if you feel that you have to leave in the meantime, please do. All right?

Thank you.

STATEMENT OF NORMAN P. STEIN, DOUGLAS ARANT PROFESSOR OF LAW, UNIVERSITY OF ALABAMA, TUSCALOOSA, ALABAMA

Mr. STEIN. Thank you. Good afternoon, or I guess, good evening. My name is Norman Stein. I am a law professor at the University of Alabama, where I teach tax, labor and employee-benefits law, and also direct a pension counseling clinic.

I commend the subcommittee for holding these hearings on employer-plan coverage and employer-plan participation issues. My remarks will concentrate on H.R. 1102, the Portman-Cardin Bill.

The ultimate goal of our tax-subsidized retirement system is to increase retirement income for those men and woman who otherwise would lack the resources necessary to support a comfortable standard of living after they stop working. Thus, the target group for the tax subsidy should be the many working people who would not be able to save adequately for retirement in the absence of employer-sponsored pension plans.

The Internal Revenue Code attempts to encourage such pension plans with a tax carrot and a policy stick. First, make sponsorship of pension plans sufficiently attractive to the tax-sensitive people who own and manage businesses that they decide to sponsor plans. And second, require such plans, once established, to provide meaningful benefits, not only to the people who set them up but also for their moderate- and lower-income employees.

This may strike some as a Rube Goldbergian way of providing retirement security for moderate- and lower-income workers, but it has resulted in at least some pension coverage for approximately half the nation's private-sector, non-agricultural workforce.

But there are two serious problems. First, while it is true that the system covers half the workforce, it is equally true that it covers only half the workforce. And second, the system fails to provide meaningful retirement income to many of the workers who are covered.

For example, the median balance in a 401(k) account today is less than $10,000, and many 401(k) account balances are substantially less than that.

Pension lawyers and consultants earn substantial incomes advising small businesses how to set up plans that minimize benefits for moderate- and lower-income workers. My students and I have seen firsthand cases in which long-tenured employees have earned retirement benefits worth only a few thousand dollars.

Thus, initiatives to reform the tax treatment of pension plans should not focus single-mindedly on creating as many new retirement plans as possible, but instead should focus on the creation of the kinds of new plans that will provide meaningful benefits not only to the well-paid but also to their moderate- and lower-income brethren.

And we should be particularly careful not to fashion reform initiatives that inadvertently slash benefit for moderate- and lower-income workers already in the system.

The Portman-Cardin plan sparkles with good intention and includes many long-overdue reforms of the current system but it also includes provisions that would retard rather than advance the admirable goals of its sponsors.

While I do not have sufficient time here to address all the bill's many complex provisions, I do want to highlight some of the most serious problems.

Under Section 401(a)(17), a plan cannot base benefit accruals or contribution allocations on compensation in excess of a $160,000 salary cap. This cap has important distributional effects, for an employer who has a target benefit or contribution in mind for an employee earning in excess of the cap must adopt a more generous benefit formula for all employees in order to provide the favored employee with the targeted benefit or contribution.

The Portman-Cardin Plan would increase the cap to $235,000. An immediate effect of this change will be the amendment of thousands of existing plans to reduce benefits for people whose compensation falls below $235,000. It is a revision that will reduce future benefits for many hard-working people.

I want to turn now to top-heavy plans.

Plans where 60 percent or more of the benefits are attributably to key employees are considered top heavy and are subject to accelerated vesting rules and minimum contribution or benefit requirements. In many cases, top-heavy plans have earned that designation because their sponsors retained expert consultants to minimize benefits for moderate- and low-income employees.

These plans are often complex because it is through he arcania of the Internal Revenue Code that consultants can manipulate plan formulas and the code's non-discrimination rules to weight benefits heavily toward the highly compensated.

The minimum-benefit requirements of the top-heavy rules ensure that these plans provide at least a minimum benefit for all employees. In 401(k) plans and age-weighted profit-sharing plans especially, these rules can mean the difference between an employee getting some pension benefit and getting no or almost no pension benefit.

H.R. 1102 includes numerous provisions, some of which add substantial new complexity to the code, that would weaken the top-heavy rules. It would be an affirmative benefit killer for thousands of working men and women who have meaningful benefits only because of the top-heavy rules.

Moreover, I fear that H.R. 1102 would mark only the first step in a march toward the complete elimination of the fairness-based rules of Section 416.

I want to skip over to the last page of my prepared testimony, "What Can Be Done," although I am skipping over—

Chairman HOUGHTON. Next to the last, see?

Mr. STEIN. Yes. Next to the last page, page 9.

Congress could increase retirement security at all income levels by enabling employers to use higher Section 415 limits and expanded salary caps, and to claim greater deductions and perhaps tax credits but only on the condition that they adopt plans that provide meaningful benefits for most of their employees.

For example, allow the generous provision in H.R. 1102 for defined-contribution plans that provide, say, a 7.5 percent non-integrated minimum contribution for all participants. No plan could possibly be simpler than this.

Congress could also consider sponsoring legislation easing the regulatory burden on employers who wish to sponsor simple defined-benefit plans that provide benefits for all of their employees.

Representatives Pomeroy's and Nancy Johnson's SAFE proposal and the administrations' SMART proposal, are giant steps forward toward this approach to improving the system. Proposals such as these would help restore the traditional qualified-plan bargain, where an employer who sponsors a retirement plan must agree to provide retirement benefits for most of its employees.

Thank you.

[The prepared statement follows:]

Statement of Norman P. Stein, Douglas Arant Professor of Law, University of Alabama, Tuscaloosa, Alabama

Good afternoon. My name is Norman Stein. I am a law professor at the University of Alabama, where I teach tax, labor, and employee benefits law, and also direct a pension counseling clinic.[1] I commend the Subcommittee for holding these hearings on employer plan coverage and employer plan participation issues. I am especially gratified that the focus of these hearings is on improving coverage for lower income

[1] The views expressed herein are my own, and do not necessarily reflect the views of the University of Alabama School of Law.

and part-time workers, for it is these groups today who are largely shut out of our tax-subsidized private sector pension system. Thank you for asking me to share my views on these and the other important issues before you. My remarks will concentrate on H.R. 1102, the Portman-Cardin bill.

Our private sector pension system is in fact a public/private partnership: a partnership between those employers who sponsor pension plans and our commonwealth, which infuses those plans with very substantial tax benefits. This fiscal year, those incentives will cost the fisc about $40 billion. The Portman-Cardin bill, if enacted, will push that figure up by several billion dollars. We should spend this much money only if it furthers, in a cost-effective way, sound retirement policy. Although there are good things in the Portman-Cardin bill, some of its major provisions would not contribute enough to good retirement policy to justify their substantial price tags, and other of its provisions would harm more people than they would help. It would be ironic and deeply unfortunate if this well-intentioned but flawed legislation is enacted, for it may well be remembered as a retirement reduction act. I fear that this possibility, an illustration of the law of unintended consequence, is all too real.

TAX POLICY AND RETIREMENT

The ultimate goal of our tax-subsidized retirement system is to increase retirement security for working Americans. The success of the system hinges on whether it increases retirement income for those men and women who otherwise would lack the resources necessary to support a comfortable standard of living after they stop working. Thus, the target group for the tax subsidy should be the many working people who would not be able to save adequately for retirement in the absence of employer-sponsored pension plans—those for whom Social Security and personal savings are not enough.

The Internal Revenue Code attempts to encourage such pension plans with a tax carrot and a policy stick: first, make sponsorship of pension plans sufficiently attractive to the tax-sensitive people who own and manage businesses so that they decide to sponsor plans to capture the tax benefits for themselves and other highly compensated employees; and second, require such plans, once they are established, to provide meaningful benefits not only to the people who set them up but also their moderate and lower income employees. This may strike some as a Rube Goldbergian way of providing retirement security for moderate and lower income workers, but it has resulted in at least some pension coverage for approximately half the nation's private-sector non-agricultural workforce.

But the system has two serious problems. First, while it is true that the system covers half the workforce, it is equally true that it covers only half the workforce. And second, the system fails to provide meaningful retirement income to many of the workers who are covered. For example, the median balance in a 401(k) account today is less than $10,000, and many 401(k) account balances are substantially less than that. Pension lawyers and consultants earn substantial incomes advising small businesses how to set up plans that minimize benefits for moderate and lower income workers. My students and I have seen firsthand cases in which long-tenured employees have earned benefits worth only a few thousand dollars.[2]

Thus, initiatives to reform the tax treatment of pension plans should not focus single-mindedly on creating as many new retirement plans as possible, but instead must focus on the creation of new plans that will provide meaningful benefits not only to the well-paid, but also to their moderate and lower-income brethren. Plans that lavish tax benefits on the highly compensated while doing little or nothing for regular workers waste the special tax expenditure for qualified plans, a tax expenditure with a 50-year history of attempting to help all Americans retire with adequate retirement income. We should be particularly careful not to fashion reform initiatives that inadvertently slash benefits for moderate and lower income workers already in the system.

LOOKING AT H.R. 1102

The Portman-Cardin Plan sparkles with good intention and includes many long overdue reforms to the current system. It would in some cases improve disclosure

[2] For example, I used a quick recipe in a reputable pension planning book to figure out how to contribute $30,000 to the defined contribution account of a 55-year old business owner earning $150,000—this is the maximum amount under today's law—while contributing the minimum to the account of his 25-year old employee earning $25,000. The answer: $571.11. Thus, the owner can contribute 20% of his own salary and just a little more than 2% of his employee's salary.

to participants, accelerate vesting in employer-matching contributions to 401(k) plans, give tax credits to help underwrite the cost of starting new plans, and expand the transferability of pension benefits between different types of plans. But it also includes provisions that would retard rather than advance the admirable goals of its sponsors. While I do not have sufficient time here to address all of the bill's many complex provisions, I do want to highlight some of the most serious problems.

1. The Increase of the Section 415 Limits

Section 415 was added to the Internal Revenue Code as part of ERISA. The purpose of section 415 is simple: the government should offer tax assistance to pension plans to the extent, but only to the extent, they build a reasonable level of retirement income for their participants. If a person wants to accumulate assets beyond their reasonable retirement needs, they should do so on their own initiative and not rely on the government to provide them special tax benefits. Section 415 implements this philosophy by limiting employer contributions to an employee's defined contribution account to $30,000 (or 25% of compensation) annually, and by limiting benefits from a defined benefit plan to a $130,000 life annuity commencing at retirement age.[3] A person fortunate enough to take maximum advantage of these limits over their career can accumulate more than five million dollars in a defined contribution plan plus one or more $130,000 retirement annuities from defined benefit plans.

The bill would increase the defined contribution plan limit from $30,000 to $45,000 and the defined benefit limit from $130,000 to $180,000, an aggregate increase of almost 50%. The argument for the increase is two-fold: first, the higher limits might tempt some employers who do not now sponsor retirement plans to adopt them, and second, they might induce employers with current plans to enhance benefit formulas for all employees (so that their highest compensated employees can take advantage of the increased limits). This is trickle-down-benefits policy.

I want to suggest that the pertinent question here is not whether some employers will adopt new plans or enact benefit increases in existing plans; but rather whether most of these new plans and benefit increases will provide meaningful additional retirement security for people who are hoping for $45,000 or even $30,000 in salaries, rather than $45,000 annual plan contributions. (And how large is the universe of employers who have decided against sponsoring a defined contribution plan because a $30,000 annual contribution is too trifling a sum to bother with, or against sponsoring a defined benefit plan because a $130,000 annuity is unworthy of their attention.)

I suspect that the primary beneficiaries of increased 415 limits will not be the paternal employer trying to help all their employees, but rather employers who are able to sponsor plans providing substantial benefits for their owners and a few highly compensated individuals and little or no benefits for their moderate and lower-income employees. If this suspicion bears out, liberalizing the section 415 limits will resemble a targeted tax break for the well-off, rather than a contribution toward sound retirement policy. Without a careful empirically-based cost/benefit analysis, the increase in the section 415 limits would simply be tossing money at a problem in the hope that it will stick to something good.[4]

2. Increase of the Section 401(a)(17) Compensation Cap

Under Section 401(a)(17), a plan cannot base benefit accruals or contribution allocations on compensation in excess of a $160,000 salary cap. This cap has important distributional effects, for an employer who has a target benefit or contribution in mind for an employee earning in excess of the cap must adopt a more generous benefit formula for all employees in order to provide the favored employee with the targeted benefit or contribution. (The targeted benefit or contribution is often the section 415 maximum.) The Portman-Cardin bill would increase the cap to $235,000. The immediate effect of this provision will be the amendment of thousands of plans to reduce benefits for people whose compensation falls below $235,000. It is a provi-

[3] These figures are each indexed to increases in the cost of living.

[4] It is also noteworthy that within the last two years. Congress relaxed the section 415 limits by repealing section 415(e) of the Internal Revenue Code, and also repealed the section 4980A excise tax on unusually large distributions. The argument for repealing section 415(e) was that it was complicated and was not needed because of the 4980A excise tax. One year later, Congress repealed section 4980A. Before doing more for the lavishly paid in the name of trickle-down benefit policy, we should examine whether the repeal of section 415(e) and 4980A has done much to expand the benefits of middle-income and lower paid employees.

sion that will slash benefits for many hard working people and should be removed from the bill.[5]

3. Top-Heavy Plans

Plans where 60% or more of the benefits go to key employees are considered top-heavy and are subject to accelerated vesting rules and minimum contribution or benefit requirements. In many cases, top-heavy plans have earned that designation because their sponsors retained expert consultants to minimize benefits for moderate and low-income employees. These plans and their administration are often complex because it is through the arcania of the Internal Revenue Code that consultants can manipulate plan formulas and the Code's nondiscrimination rules to weight benefits heavily toward the higher compensated.

The minimum benefit requirements of the top-heavy rules ensure that these plans provide at least a minimum benefit for all employees. In 401(k) plans and age-weighted profit-sharing plans, especially, these rules can mean the difference between an employee getting some pension benefit and getting no or almost no pension benefit. H.R. 1102 includes numerous provisions—some of which actually add substantial new complexity to the Code—that would weaken the top heavy rules. It would be another affirmative benefit killer for thousands of working men and women who have meaningful benefits only because of Section 416. Moreover, I fear that H.R. 1102 would mark only the first step in a march to the complete elimination of the fairness-based rules of Section 416.

4. Encouraging Do-It-Yourself Savings Programs

In traditional employer-paid plans, an employer would provide benefits to most of its employees, including those who were moderately paid. The employees generally had no choice in the matter. This might be viewed as tax-induced employer paternalism, but the system worked for many people who otherwise would have saved little for retirement. Section 401(k) plans and variations on it such as the SIMPLE, depart from this mold. In such plans, employees have a choice between cash or deferral. This election is not always attractive to many moderate- and low-income workers, who have immediate, family-driven needs for present compensation. Moreover, these employees have relatively low marginal tax rates and thus receive a much smaller tax incentive to participate in these plans than better compensated employees. In effect, they receive a lower governmental matching contribution than the higher compensated.

Why are we surprised, then, that employee participation in Section 401(k) plans declines as compensation declines? The answer to this problem is not the creation of more do-it-yourself savings vehicles; it is a return to the type of plan that ensured participation of those working people least able to save on their own and least benefitted by the tax deferral offered by employer-sponsored pension plans.

H.R. 1102 includes a virtual smorgasbord of provisions that either increase an employer's incentive to switch from a traditional employer-pay plan to a 401(k) plan (the "Roth" 401(k) provision, the increases in elective deferrals, the tinkering with the deduction limits), and lower the employer's incentive to provide benefits for moderate and lower-income employees (changes to the top-heavy rules, salary reduction only SIMPLEs and automatic contribution trusts). The moderate and lower-income employees currently left out in the cold will find little shelter in these provisions.

5. Repeal of Current Liability Funding Limit

The Code currently limits deductible employer contributions to defined benefit plans to 150% of current liability. In plans with certain demographic features, best-practice actuarial methodology would mandate larger contributions. There are two problems with eliminating the 150% limitation. First, for some plans, particularly small defined benefit plans, funding benefits at 150% of current liability does not present a meaningful risk to benefit security and eliminating the limitation for these plans will have serious revenue costs. Thus, the provision is overbroad and extends generous deduction limits where they are not needed. Second, eliminating the 150% limitation will result, once again, in seriously overfunded plans, which tempt plan sponsors to consider plan termination to capture the surplus. This was an important justification for creation of the limit in the 1987. A repeal of the limit should thus be limited to those plans where the employer waives any right to artificial termination-basis surplus assets thereby created.

[5] The 25-year-old woman in footnote 2 would see her benefit drop to $364.54 with no effect at all on the $30,000 allocation to her boss.

6. The IRA Contribution Limit

Under current law, IRA deductions are limited to $2,000. H.R. 1102 would lift this limit to $5,000. While at one level this is positive, it will have the effect of discouraging some small businesses from sponsoring employer plans. For example, if the owner of a business wants to defer only $5,000, she could accomplish that by contributing to an IRA rather than sponsoring a plan that would also provide benefits to her employees. Here again, the intentions of H.R. 1102 are good, but the unintended consequences will result in less benefits for many working people.

WHAT CAN BE DONE

Congress could increase retirement security for Americans at all income levels by enabling employers to use higher section 415 limits and expanded salary caps, and to claim greater tax deductions (and perhaps tax credits), but only on the condition that their plans provide meaningful benefits for most of its employees. For example, allow the generous provisions in H.R. 1102 for defined contribution plans that provide, say, a 7.5% nonintegrated minimum contribution for all participants. Or a defined benefit plan that provides all employees a non-integrated 2% benefit, indexed to the cost of living. Congress could also consider sponsoring legislation easing the regulatory burden on employers who wish to sponsor simple defined benefit plans that provide benefits for all of their employees. Representative Pomeroy's SMART proposal is a giant step toward this approach to improving the system.

Proposals such as these would help restore the traditional qualified-plan bargain, where an employer who sponsors a retirement plan must use that plan to provide retirement benefits for most of its employees.

I am happy to take any questions.

Chairman HOUGHTON. OK. Well thank you very much, Mr. Stein, and I am terribly sorry that we have had to hold everybody, but, as you know, we have had these votes.

So, Ms. Heinz, great to see you here. Thank you very much for coming.

STATEMENT OF TERESA HEINZ, CHAIRMAN, HEINZ FAMILY PHILANTHROPIES

Ms. HEINZ. Thank you very much, Chairman Houghton, Congressman Coyne, and Members of the subcommittee. I am delighted to be here today to talk about the importance of women in the context of the overall Congressional discussion of the future of pension policy in America.

This is something that, in part, I have inherited from my late husband, Senator John Heinz, and his great interest in long-term care and pensions for women, specifically. And we have continued to do this work in the Heinz Family Philanthropies, and we are committing to ensure that women have the information and skills needed to surmount the overwhelming challenges to secure retirement income.

In 1996, our foundation launched the Women's Institute for Secure Retirement, known also as WISER, to implement these goals. The reality of today is that most Americans, regardless of their gender, are ill-prepared for their retirement. A fate that awaits most women, however, is by far the more troublesome problem. Of the 63 million baby-boomers in America, fully 32 million are saving less than one third of what they will need for retirement.

And the overwhelming majority of those unprepared for retirement are women.

Today, women earn on average 74 cents for every dollar earned by men, which creates less of an opportunity for retirement savings. Nearly three-fourths of full-time working women earn less than $30,000. In fact, the median income is only $22,000. Of course, the numbers are even worse for minority women, where half of all African American women earn less than $20,000, and for Hispanic women, that number is just under $16,000.

Women are at a structural disadvantage too. Their work patterns provide them with fewer pensions and less time to accumulate savings through their workplace, yet they need more income because they live longer.

Currently, 40 percent of all women's jobs are now non-standard. These non-standard jobs are part time, contract, freelance, and they are often combined to create one full-time job. Moreover, more and more employers are incentivizing non-standard work by offering permanent part-time positions, guaranteed part-time jobs with no benefits.

These non-standard jobs also mean lower wages, fewer if any employee benefits, and more often than not, no company pension plan. In fact, I am reminded last July, reading that Microsoft had a huge number of employees who were on permanent status with no-benefits. That is quite shocking.

In spite of work outside the home, women have not been relieved of their responsibilities as family care-givers. In addition to the time they spend at home on maternity leave, they also bear the primary responsibility for caring for the ill child or the sick relative resulting in diminished job tenures.

These shorter careers can have serious repercussions at retirement because fewer years of work and/or breaks in employment affect pension eligibility and result in lower benefits under pensions and the Social Security system.

The data shows that women on average spend almost 15 percent of their working years out of the job market while men miss out on less than 2 percent of their working years. As a result of a woman's dual burden of caring for her family and working outside of the home, the majority of working women are generally disadvantaged in their lack of knowledge of pensions and investments.

Nearly 40 percent of women are dependent on Social Security for almost all of their income because they have had fewer opportunities to participate in the retirement plans provided by employers. The combination of lower income, fewer pension opportunities as well as less knowledge on their part, means that women are more likely to get lower returns on investments when they are able to save.

They are more likely to choose lower risk, lower return vehicles. Women are more likely than men to have money in a regular savings or money-market account, life insurance, or U.S. Savings bonds. Men are more likely than women to have money in mutual funds, real estate, and 401(k)'s.

Mr. Chairman, while we applaud this committee for allowing us to focus attention on the ways in which the system's current inadequacies affect working women, expanding savings opportunities may not have much effect on the women we should be most concerned about.

Most working women are struggling from paycheck to paycheck, juggling their finances to find the income to contribute to their 401(k) savings plan.

And, Mr. Chairman, research from the Heinz Foundation/Sun America National Women's Retirement Survey found that 61 percent of women reported that they usually have little to no money left after paying bills to save for retirement. And for African American and Hispanic women, it is even worse. Seventy-five percent for African American and 69 percent for Hispanic women have no money left for retirement savings.

The Comprehensive Retirement Security and Pension Reform Act of 1999 introduced by Congressmen Portman and Cardin contains several provisions that will help women who work in small businesses. This is particularly important given that only 20 percent of small businesses offer retirement plans.

First and foremost, the legislation contains provisions that will make it easier for small business to offer pension plans. Second, the legislation requires accelerated vesting in three years instead of five years for employer matching contributions in 401(k) plans.

Finally, the legislation also provides portability.

Therefore, whatever pension reforms the Congress ultimately considers, we have got to be clear about who will benefit from these reforms. If this Congress and this Administration are truly committed to reducing and ultimately wiping out the fact that the face of poverty in old age is distinctly female, then hearings like this one become increasingly important.

But if this issue continues to be politicized and ultimately no action is taken, I hope we will see a groundswell of women voting, some for the first time because of this issue.

For example, in the 1996 Senate race in Massachusetts, where both candidates had good records on the more obvious women's issues, the winner carried the woman's vote by more than 20 percent based on two issues, economic security and education.

Mr. Chairman, no one, Republican of Democrat, wants to or can afford to take voting power of women for granted. It is particularly relevant in a job market where women owned businesses, the majority of small businesses, are the fastest growing sector in the job, and in the economy. And today, women-owned businesses employ more than all the people employed by the top Fortune 500 companies.

Economic security is an issue that women care and are thinking about very much these days. I think it is up to all of us, here and elsewhere, to give them all the choices they deserve.

Thank you.

[The prepared statement follows:]

Statement of Teresa Heinz, Chairman, Heinz Family Philanthropies

Chairman Houghton, Congressman Coyne and Members of the subcommittee, I am delighted to be here today to talk about the importance of women in the context of the overall Congressional discussion of the future of pension policy in America. Let me state from the outset that resolution of this nation's retirement policy, or the lack of one, is of paramount importance for all, but most especially if we are to combat the growing problem of poverty in old age being distinctly female. The Heinz Family Philanthropies are committed to ensuring that women have the information and skills needed to surmount the overwhelming challenges to secure retirement income. In 1996, the Foundation launched the Women's Institute for Secure Retirement (WISER) to implement these goals.

The reality of today is that most Americans, regardless of their gender, are ill-prepared for their retirement. The fate that awaits most women, however, is by far the more troublesome problem. Of the 63 million baby-boomers in America, fully 32 million are saving less than one-third of what they will need for retirement—and the overwhelming majority of those unprepared for retirement are women.

Today, women earn, on average, 74 cents for every dollar earned by men which creates less of an opportunity for retirement savings. Nearly, three-fourths of full-time working women earn less than $30,000, in fact their median income is only $21,883. Of course, the numbers are even worse for minority women, where half of all African American women earn less than $19,741 and for Hispanic women it's only $15,967.

Women are at a structural disadvantage too. Their work patterns provide them with fewer pensions and less time to accumulate savings through their workplace, yet they need more income because they live longer. Currently, 40 percent of all women's jobs are now non-standard. These non-standard jobs are part-time, contract, freelance and are often combined to create one full-time job. Moreover, more and more employers are incentivizing non-standard work by offering permanent part-time positions—guaranteed part-time jobs with no benefits. These non-standard jobs also mean lower wages, fewer if any employee benefits, and more often than not, no company pension plan.

In spite of work outside the home, women have not been relieved of their responsibilities as family caregivers. In addition to the time women are home on maternity leave, they also bear the primary responsibilities of caring for an ill child or sick relative resulting in diminished job tenures. These shorter careers can have serious repercussions at retirement because fewer years of work and/or breaks in employment affect eligibility and lower benefits under employer pensions and Social Security. The data shows that women, on average, spend almost 15% of their working years out of the job market, while men miss out on less than 2% of their working years.

As a result of a woman's dual burden of caring for her family and working outside of the home, the majority of working women are generally disadvantaged in their knowledge of pensions and investments. Nearly 40% of women are dependent on Social Security for almost all of their income because they have had fewer opportunities to participate in the retirement plans provided by employers.

The combination of lower income, and fewer pension opportunities as well as less knowledge means that women get lower returns on investments when they are able to save. They are more likely to choose lower risk, lower return vehicles. Women are more likely than men to have money in a regular savings or money market account, life insurance, and U.S. Savings Bonds. Men are more likely than women to have money in mutual funds, real estate, and 401(k)s.

Mr. Chairman, while we applaud this committee for allowing us to focus attention on the ways in which the system's current inadequacies affect working women, expanding savings opportunities may not have much effect on the women we should be most concerned about—most working women are struggling from paycheck to paycheck, juggling their finances to find the income to contribute to their 401(k) savings plans. And, Mr. Chairman, research from the Heinz Foundation/Sun America 1998 National Women's Retirement Survey found that 61% of women reported that they usually have little to no money left after paying bills to save for retirement. For African-American and Hispanic women this problem is even more pronounced—75% of African American women and 69% of Hispanic women reported no money left for retirement savings.

The Comprehensive Retirement Security and Pension Reform Act of 1999 introduced by Congressmen Portman and Cardin contains several provisions that will help women. This is particularly important given that only 20% of small businesses offer retirement plans. First and foremost the legislation contains provisions that will make it easier for small businesses to offer pension plans. Second, the legislation requires accelerated vesting in three years instead of five years for employer matching contributions in 401(k) plans. Finally, the legislation provisions makes pension portability easier.

However, in whatever pension reforms the Congress ultimately considers, we have got to be clear about who will benefit from these reforms.

If this Congress and this Administration are truly committed to reducing and ultimately wiping out the fact that the face of poverty in old age is distinctly female, then hearings like this one become increasingly important. But, if this issue continues to be politicized, and ultimately no action is taken, I hope we will see a ground swell of women voting—some for the first time—saying we won't take it anymore!

Mr. Chairman, no one—Republican or Democrat—wants to take the voting power of women for granted. Economic security is an issue that women think, care and vote about. It's up to all of us to give them good choices.

Chairman HOUGHTON. Thank you very much, Ms. Heinz. Robert Chambers is a partner in Montgomery, McCracken, Walker & Rhoads of Philadelphia, and is here on behalf of the Association of Private Pension and Welfare Plans.

STATEMENT OF ROBERT G. CHAMBERS, PARTNER, MONTGOMERY, McCRACKEN, WALKER & RHOADS, LLP, PHILADELPHIA, PENNSYLVANIA; ON BEHALF OF ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS

Mr. CHAMBERS. Thank you. Mr. Chairman and Members of the subcommittee. I am, as you indicated, Robert Chambers. I am partner in the Philadelphia-based law firm of Montgomery, McCracken, Walker & Rhoads. I am here on behalf of APPWP, The Benefits Association, where I serve as a director and as chair of the retirement income task force. APPWP is a public policy organization representing principally Fortune 500 companies and other organizations that assist plan sponsors in providing benefits to employees.

It is a privilege, Mr. Chairman, for me to testify before you today, and I want to commend you for holding this hearing on the critical role that our private retirement system plays in helping American families achieve retirement security. APPWP believes that there is a clear step that Congress can take to strengthen the system and to extend the benefits of pension coverage to more American workers.

That step is the prompt consideration and passage of H.R. 1102, the Comprehensive Retirement Security and Pension Reform Act of 1999, which was recently introduced by Reps. Portman and Cardin, together with a large group of bipartisan co-sponsors, including Rep. Weller, Rep. Lewis, and, of course, you.

Reps. Portman and Cardin have rolled up their sleeves and have done the heavy lifting that is required to craft pension reform proposals that are responsible and technically sound. With this bill, they have once again demonstrated both leadership and vision in setting a comprehensive course for improvement of our employer-based retirement system.

Mr. Chairman, I would like to use my oral remarks to focus on what APPWP considers to be the backbone of the bill: how the Federal Government can encourage employers to create and to maintain tax-qualified retirement plans for their employees. I will briefly touch on four parts of H.R. 1102 that are critical to this effort: restoration of contribution and benefit limits, simplification of pension regulation, enhanced pension portability, and improved pension funding.

One of the most significant reforms contained in H.R. 1102 is the restoration of several contribution and benefit dollar limits to their previous levels. These limits have been reduced repeatedly for budgetary reasons and are lower today in actual dollar terms, to say nothing of the effect of inflation, than they were many years ago.

The limit restorations in H.R. 1102 give practical significance to the calls by the President, the Vice President, and bipartisan congressional leadership last June at the National Summit on Retirement Savings to allow Americans to save more effectively for their retirement.

Based on my experience in the retirement plan arena, I am convinced that restored limits will result in greater pension coverage. Restored limits will convince businessowners that they will be able to fund a reasonable retirement benefit for themselves and for key employees; will encourage these individuals to establish and to improve retirement plans, and will result in pension benefits for more rank-and-file employees.

These restored limits are also important to the many baby boomers who must increase their savings to provide adequate retirement income. The catch-up provision contained in the bill, which would permit those employees who have reached age 50 to contribute an additional $5,000 each year to a defined contribution plan, will likewise address the savings needs of baby boomers and will provide an especially important savings tool for those women who leave their jobs for extended periods to raise children and to care for elderly family members.

The bill would also remedy a current restriction on savers of modest levels. Annual contributions to a defined contribution plan for all employees currently are limited to the lesser of $30,000 or 25 percent of compensation. Unfortunately, the percentage of compensation restriction actually limits the retirement savings of modest income workers while having no effect on the highly paid. Removing this percentage cap on compensation would eliminate a barrier that blocks the path of many modest income savers.

Another vitally important component of H.R. 1102 is the broad array of simplification proposals that will streamline many of the incomprehensible pension rules that currently choke our private retirement system. Throughout my career, Mr. Chairman, I have found that this morass of pension regulations creates fear and loathing among many corporate decision-makers and drives them from the private retirement system.

The bill's simplification measures include reform of the separate lines of business rules, repeal of the duplicative multiple-use test, clarification of the top-heavy rules, new flexibility in the coverage and non-discrimination tests, and an earlier funding valuation date for defined benefit plans. APPWP believes that the cumulative effect of the bill's regulatory reforms will be truly significant.

Another important advance in H.R. 1102 is the cluster of provisions designed to enhance pension portability. These provisions would ease plan administration, help individual workers who wish to take their savings with them when they move to another job, and reduce leakage from the retirement system by expanding the circumstances in which rollovers would be permitted. The bill's portability initiatives would also help to eliminate several rigid regulatory barriers, such as the same desk and anti-cutback rules which have impeded benefit portability.

APPWP is pleased that H.R. 1102 would also repeal the 150 percent current liability funding limit. This would cure a budget-driven constraint that has prevented employers of all sizes from funding the benefits that they have provided to their workers and would provide enhanced security for future retirees.

Mr. Chairman, thank you again for the opportunity to appear this afternoon and to share APPWP's views on ways to strengthen our Nation's private retirement system. We appreciate your commitment to this goal, and we applaud Representatives Portman and Cardin and those with whom they have worked for crafting and co-sponsoring a bill that will make this goal a reality.

[The prepared statement follows:]

Statement of Robert G. Chambers, Partner, Montgomery, McCracken, Walker & Rhodes, LLP, Philadelphia, Pennsylvania; on behalf of the Association of Private Pension and Welfare Plans

Mr. Chairman and Members of the Subcommittee, I am Robert Chambers, and I am a partner in the Philadelphia-based law firm of Montgomery, McCracken, Walker & Rhoads, LLP. I am here as the representative of the Association of Private Pension and Welfare Plans (APPWP—The Benefits Association), where I serve as director and chair of the Retirement Income Task Force. APPWP is a public policy organization representing principally Fortune 500 companies and other organizations that assist plan sponsors in providing benefits to employees. Collectively, APPWP's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

It is a privilege, Mr. Chairman, for me to testify before you today, and I want to commend you for holding this hearing on the critical role the employment-based pension system plays in helping American families achieve retirement security. We at APPWP share your commitment to seeing that the private retirement system is made even stronger.

Fortunately, APPWP believes there is a clear step that Congress can take to strengthen the system and extend the benefits of pension coverage to even more American workers. That step is prompt consideration and passage of H.R. 1102, the Comprehensive Retirement Security and Pension Reform Act of 1999, which was recently introduced by Representatives Rob Portman (R–OH) and Ben Cardin (D–MD) together with a large group of bipartisan cosponsors including the distinguished chairman of this Subcommittee, Rep. Amo Houghton (R–NY), as well as Representative Jerry Weller (R–IL) and Representative John Lewis (D–GA). Representatives Portman and Cardin have once again rolled up their sleeves and done the heavy lifting that is required to master the intricacies of our pension laws and to craft reform proposals that are responsible and technically sound. With this bill, they have continued their long-standing commitment to retirement savings issues and have demonstrated both leadership and vision in setting a comprehensive course for improvement of our nation's employment-based retirement system.

Mr. Chairman, while H.R. 1102 contains a whole series of important reforms, I would like to focus on the four areas of the bill that APPWP believes are of particular importance for advancing our nation's pension policy—(1) restoration of contribution and benefit limits, (2) simplification of pension regulation, (3) enhanced pension portability and (4) improved defined benefit plan funding.

Restoration of Contribution and Benefit Limits

One of the most significant reforms in H.R. 1102 is the restoration of a number of contribution and benefit limits to their previous dollar levels. These limits cap the amount that employees and employers may save for retirement through defined contribution plans as well as limit the benefits that may be paid out under defined benefit pension plans. Many of these dollar limits have been reduced repeatedly since the time of ERISA's passage. Today, they are far lower in actual dollar terms—to say nothing of the effect of inflation—than they were many years ago.

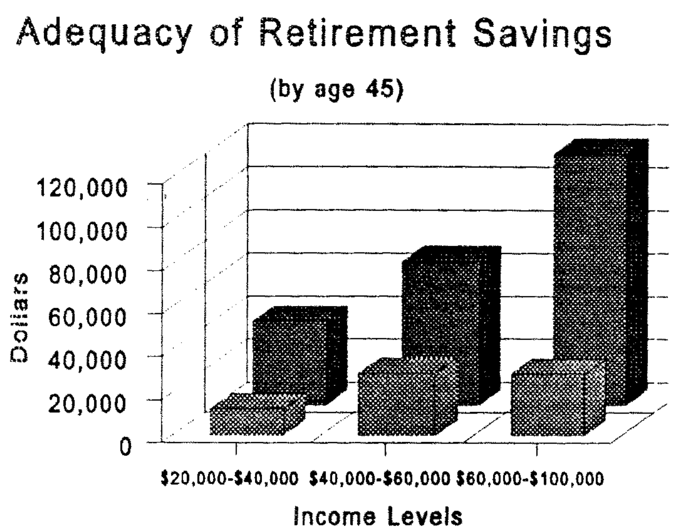
During the 1980's and early 1990's, Congress repeatedly lowered retirement plan contribution and benefit limits for one principal, if frequently unstated reason: to increase the amount of revenue that the federal government collects. It is time to put an end to that type of short-term thinking. It is true that under federal budget scorekeeping rules, proposals that encourage people to contribute more to retirement savings cost the federal government money in the budget-estimating window period.

Yet incentives that effectively increase retirement savings are among the best investments we can make as a nation. They will pay back many times over when individuals retire and have not only a more secure retirement, but also increased taxable income. Increased retirement savings also generates important investment capital for our economy as a whole.

It is time that retirement policy rather than short-term budgetary gains guide Congress' actions in the plan limits area. The Portman-Cardin legislation wisely takes this approach by restoring a series of contribution and benefit limits to their intended levels. These limit restorations give practical significance to the calls by the President, Vice President and bipartisan congressional leadership last June at the National Summit on Retirement Savings to allow Americans to save more effectively for their retirement.

Restored limits are critical for a number of reasons. They would help return us to the system of retirement plan incentives intended at the time of ERISA's passage. In our voluntary pension system, it has always been necessary to interest the key corporate decision-makers in initiating a retirement plan in order that rank-and-file workers receive pension benefits. An important part of generating this interest is demonstrating that these individuals will be able to fund a reasonable retirement benefit for themselves. The contribution and benefit limit reductions of recent years have reduced the incentives for these decision-makers, giving them less stake in initiating or maintaining a tax-qualified retirement plan. Restoring the limits will encourage these individuals to establish and improve retirement plans, with the all-important result that more rank-and-file workers will receive pension benefits.

Restored limits are also important so that the many baby boomers who have not yet saved adequately for retirement have the chance to do so. A reduced window in which to save or accrue benefits clearly means one must save or accrue more, and restoring limits will allow this to occur. Of particular concern is the fact that it appears that older baby boomers are not increasing their level of saving as they move into their mid-to-late 40s. Rather, they are continuing to fall further behind—with savings of less than 40 percent of the amount needed to avoid a decline in their standard of living in retirement.



Source: Dr. B. Douglas Bernheim, Merrill Lynch Baby Boom Retirement Index 1995

Every day's delay makes the retirement savings challenge more difficult to meet, and every day's delay makes the prospect of catching up more daunting. Individuals who want to replace one-half of current income in retirement must save 10 percent of pay if they have 30 years until retirement. These same individuals will have to save 34 percent of pay if they wait until 15 years before retirement to start saving.

Required Saving as a Percent of Income

Desired Retiree Income as a % of Annual Salary [In percent]	Years Until Retirement					
	10 [In percent]	15 [In percent]	20 [In percent]	25 [In percent]	30 [In percent]	35 [In percent]
30%	36%	21%	13%	9%	6%	4%
40	48	27	18	12	8	6
50	60	34	22	15	10	7
60	72	41	26	18	12	9
70	84	48	31	21	14	10

Source: T. Rowe Price, as printed in Committee for Economic Development Statement "Who Will Pay For Your Retirement—The Looming Crisis" 1995

Along with restored limits, H.R. 1102 contains a specific tool to help workers meet this savings challenge. The catch-up contribution contained in the bill—which would allow those who have reached age 50 to contribute an additional $5,000 each year to their defined contribution plan—will help address the savings needs of baby boomers and will be an especially important savings tool for women. Many workers find that only toward their final years of work, when housing and children's education needs have eased, do they have enough discretionary income to make meaningful retirement savings contributions. This problem can be compounded for women who are more likely to have left the paid workforce for a period of time to raise children or care for elderly parents and thereby not even had the option of contributing to a workplace retirement plan during these periods.

The catch-up provision of H.R. 1102 recognizes these life cycles and also acknowledges the fact that, because Section 401(k) plans have only recently become broadly available, the baby-boom generation has not had salary reduction savings options available during much of their working careers. The catch-up provision would help ensure that a woman's family responsibilities do not result in retirement insecurity and would help all those nearing retirement age to meet their remaining savings goals. While some catch-up contribution designs would create substantial administrative burden for plan sponsors, the simple age eligibility trigger contained in the Portman-Cardin bill does not and will result in more companies offering this important savings tool to their workers.

There is an additional savings enhancement contained in the bill that APPWP wishes to highlight briefly. Under current law, total annual contributions to a defined contribution plan for any employee are limited to the lesser of $30,000 or 25% of compensation. Unfortunately, the percentage of compensation restriction tends to unfairly limit the retirement savings of relatively modest-income workers while having no effect on the highly-paid. For example, a working spouse earning $25,000 who wants to use his or her income to build retirement savings for both members of the couple is limited to only $6,250 in total employer and employee contributions. By removing the percentage of compensation cap, H.R. 1102 would remedy this perverse effect of current law and remove a barrier that blocks the path of modest-income savers.

SIMPLIFICATION

Another vitally important component of H.R. 1102 is the series of simplification proposals that will streamline the incomprehensible pension rules that today still choke the employer-provided retirement system. Throughout my career, Mr. Chairman, I have counseled hundreds of clients and been involved in the design and implementation of countless pension plans. It is my conclusion from this experience that the astounding complexity of pension regulation drives business people out of the retirement system and deters many from even initiating a retirement plan at all. Not only are business people leery of the cost of complying with such regulation, but many fear that they simply will be unable to comply with rules they cannot understand. We must cut through this complexity if we are to keep those employers with existing plans in the system and prompt additional businesses to enter the system for the first time.

A more workable structure of pension regulation can be achieved only by adhering to a policy that encourages the maximization of fair, secure, and adequate retirement benefits in the retirement system as a whole, rather than focusing solely on ways to inhibit rare (and often theoretical) abuses. This can be accomplished by ensuring that all pension legislation is consistent with continued movement toward a simpler regulatory framework. In short, simplification must be an ongoing process. Proposals that add complexity and administrative cost, no matter how well intentioned, must be resisted, and the steps taken in earlier pension simplification legislation must be continued. Current rules must be continuously reexamined to weed out those that are obsolete and unnecessary. Representatives Portman and Cardin have led past congressional efforts at simplification, and APPWP commends them for continuing this important effort in their current bill.

As I indicated, Mr. Chairman, H.R. 1102 contains a broad array of simplification provisions to address regulatory complexity. Let me briefly mention a few that APPWP believes would provide particular relief for plan sponsors. First, the bill would reform the separate lines of business rules so that these regulations serve their intended purpose—allowing employers to test separately the retirement plans of their distinct businesses. Second, the bill would simplify and streamline the top-heavy rules, which are a source of much unnecessary complexity for small employers. Third, the bill would repeal the duplicative multiple use test, which will eliminate a needless complexity for employers of all sizes. Fourth, the legislation would provide flexibility with regard to the coverage and non-discrimination tests in current law, allowing employers to demonstrate proper plan coverage and benefits either through the existing mechanical tests or through facts and circumstances tests. And fifth, the bill would promote sounder plan funding and predictable plan budgeting through earlier valuation of defined benefit plan funding figures.

APPWP believes that the cumulative effect of the bill's regulatory reforms will be truly significant. Reducing the stranglehold that regulatory complexity holds over today's pension system will be a key factor in improving the system's health and encouraging new coverage over the long-term. As H.R. 1102—and pension legislation generally—progress through this Subcommittee and the Congress, Mr. Chairman, we would urge you to keep these simplification measures at the very top of your reform agenda.

PORTABILITY

Another important advance in H.R. 1102 is the cluster of provisions designed to enhance pension portability. Not only will these initiatives make it easier for individual workers to take their defined contribution savings with them when they move from job to job, but they will also reduce leakage out of the retirement system by facilitating rollovers where today they are not permitted. In particular, the bill's provisions allowing rollovers of (1) after-tax contributions and (2) distributions from Section 457 plans maintained by governments and tax-exempt organizations will help ensure that retirement savings does not leak out of the system before retirement.

The bill's portability initiatives would also help eliminate several rigid regulatory barriers that have acted as impediments to portability. Repeal of the "same desk" rule will allow workers who continue to work in the same job after their company has been acquired to move their defined contribution account balance to their new employer's plan. Reform of the "anti-cutback" rule will make it easier for defined benefit plans to be combined and streamlined in the wake of corporate combinations. We specifically want to thank Representatives Portman and Cardin for the refinements they have made to their portability provisions in response to several administrative concerns raised by APPWP and others. We believe the result is a portability regime that will work well for both plan participants and plan sponsors.

DEFINED BENEFIT PLAN FUNDING

APPWP is also pleased that H.R. 1102 includes an important pension funding reform that we have long advocated. The bill's repeal of the current liability funding limit would remove a budget-driven constraint in our pension law that has prevented companies from funding the benefits they have promised to their workers. The calculation of this funding limitation requires a separate actuarial valuation each year, which adds to the cost and complexity of maintaining a defined benefit plan. More importantly, the current liability funding limit forces systematic underfunding of plans, as well as erratic and unstable contribution patterns. Limiting funding on the basis of current liability disrupts the smooth, systematic accumulation of funds necessary to provide participants' projected retirement benefits. In effect, current law requires plans to be funded with payments that escalate in later years. Thus, employers whose contributions are now limited will have to contribute more later to meet the benefit obligations of tomorrow's retirees. If changes are not made now, some employers may be in the position of being unable to make up this shortfall and be forced to curtail benefits or terminate plans. Failing to allow private retirement plans to fund adequately for the benefits they have promised will put more pressure on Social Security to ensure income security for tomorrow's retirees.

The problems caused by precluding adequate funding are compounded by a 10 percent excise tax that is imposed on employers making nondeductible contributions to qualified plans. This penalty is clearly inappropriate from a retirement policy perspective. Employers should not be penalized for being responsible in funding their pension plans. The loss of an immediate deduction should, in and of itself, be a sufficient deterrent to any perceived abusive "prefunding."

The net effect of the arbitrary, current liability-based restriction on responsible plan funding, and the 10 percent excise tax on nondeductible contributions, is to place long-term retirement benefit security at risk. With removal of this limit and modification of the excise tax, H.R. 1102 would provide the enhanced security for future retirees that comes with sound pension funding.

ADDITIONAL PROPOSALS

Our testimony today has focused on only a few of the important changes contained in H.R. 1102. There are many other proposals in the bill that would also substantially improve our private pension system, and I want to touch briefly on a few of them before concluding. First, the bill includes a change in the treatment of ESOP dividends that would provide employees with a greater opportunity for enhanced retirement savings and stock ownership. Second, it creates a new designed-based safe harbor—the Automatic Contribution Trust (ACT)—which encourages employers to enroll new workers automatically in savings plans when they begin employment. Automatic enrollment arrangements such as the ACT have been shown to boost plan participation rates substantially, particularly among modest-income workers. Third, the legislation includes a number of incentives targeted at small employers—a tax credit for new plans, simplified plan reporting, discounted PBGC premiums and waived IRS user fees—to make it easier for today's dynamic small businesses to offer retirement benefits to their workers.

Mr. Chairman, the complexity of America's workplace and the diversity of America's workforce require that we maintain an employment-based retirement system that is flexible in meeting the unique needs of specific segments of the workforce and that can adapt over time to reflect the changing needs of workers at different points in their lives. For this reason, there is no single "magic" solution to helping Americans toward a more secure retirement. Rather a comprehensive series of responsible and well-developed proposals—such as those found in H.R. 1102—is the best way to make substantial progress in strengthening our already successful private retirement system.

* * * * *

Mr. Chairman, thank you again for the opportunity to appear this afternoon and share APPWP's views on ways to strengthen our nation's private retirement system. We commend your commitment to this goal and salute Representatives Portman and Cardin, and those with whom they have worked, for crafting and cosponsoring a bill that will make this goal a reality. We look forward to working in close partnership to achieve passage of this much-needed legislation.

Chairman HOUGHTON. Thank you very much, Mr. Chambers.

Now, Mr. O'Connell.

STATEMENT OF DANIEL P. O'CONNELL, CORPORATE DIRECTOR, EMPLOYEE BENEFITS AND H.R. SYSTEMS, UNITED TECHNOLOGIES CORPORATION, AND VICE CHAIRMAN, ERISA INDUSTRY COMMITTEE

Mr. O'CONNELL. Good afternoon. My name is Daniel O'Connell. I am testifying today on behalf of The ERISA Industry Committee. I am vice chairman of the board of directors of ERIC; I am also the Corporate Director of Employee Benefits and Human Resources Systems for United Technologies.

The Internal Revenue Code currently imposes a dizzying array of limits on the benefits that can be paid from and the contributions that can be made to tax-qualified plans. It was not always that way. The limits originally imposed by ERISA in 1974 allowed nearly all workers participating in employer-sponsored plans to accumulate all of their retirement income under funded tax-qualified plans. However, between 1982 and 1994, Congress enacted a series of laws that repeatedly lowered the ERISA limits and imposed wholly new limits.

The cumulative effect of constricted limits has been to reduce significantly the retirement savings and imperil the retirement security of many workers. H.R. 1102 turns this tide at a critical time. The subcommittee does not need to be reminded that the baby boom cohort is rapidly nearing retirement. H.R. 1102 provides an opportunity we cannot afford to pass up.

Consider the following: First, savings accumulated in tax-qualified retirement plans are not a permanent revenue loss the Federal Government Second, while retirement savings are accumulating in tax-qualified plans, they serve as an engine for economic growth. Thereby, they indirectly produce additional revenue for the Federal Government and directly enhance the ability of the Nation to absorb its aging population and the needs of that group. In 1994, pension funds held 28.2 percent of our Nation's equity market, 15.6 percent of its taxable bonds, and 7.4 percent of its cash securities.

Third, many of today's workers' savings and benefits opportunities are significantly restricted by the current limits. Recently, in one ERIC company, workers who were leaving under an early retirement program and who had career-end earnings of less than $50,000 had their benefits under their defined benefit plan reduced by the qualified plan limits.

Fourth, limits imposed on the defined benefit plans imprudently delay current funding for benefits that workers are accruing today, because the tax law limits arbitrarily truncate projections of future salaries on which these benefits will be calculated. One of the major purposes of ERISA was to avert precisely this kind of benefit insecurity.

Fifth, we currently have a bifurcated world—and a number of the other speakers have addressed this already—in which business decision-makers depend increasingly upon unfunded, non-qualified plans for the bulk of their retirement savings.

Let me address, next, pension portability. Employers and employees increasingly are involved in mergers, business sales, the creation of joint ventures, and other changes in business structures. H.R. 1102 promotes pension portability by eliminating a number of significant stumbling blocks to portability created under current law.

ERIC is especially appreciative that the bill repeals the same desk rule. The same desk rule prevents employees from rolling over their 401(k) accounts into IRAs or consolidating them with their accounts under the buyers' plan. 401(k)s are the only tax-qualified plans that are subject to the same desk rule, and the rule does not apply even in all transactions involving 401(k) plans. There is no justification for singling out 401(k) plans for special restrictions on distributions in this manner.

ERIC also supports the bill's provisions that facilitate plan-to-plan transfers by providing that the receiving plan does not need to maintain all of the optional forms of benefit of the sending plan.

ERIC would expand the bill's provisions that allow rollovers of after-tax contributions. Current rules are not only confusing to employees but force them to strip a portion of their savings from their accounts just because the savings were made with after-tax contributions.

Finally, with regard to rules for plan administration. Superfluous, redundant, confusing, and obsolete rules encumber the administration of tax-qualified retirement plans. These rules unnecessarily increase the cost of plan administration, discourage the formation of plans, and make retirement planning more difficult for employees.

We are very pleased that H.R. 1102 significantly advances the work Congress began in earlier bills to strip away these regulatory barnacles, especially provisions that update the definition of an ERISA excess plan and that provide that suspension of benefit notices can be provided through the summary plan description.

This completes my prepared statement. I would like to thank the Chair and the Members of the subcommittee for giving ERIC the opportunity to testify, and I will be happy to respond to any of the questions that the Members of the subcommittee may have. Thank you.

[The prepared statement follows:]

Statement of Daniel P. O'Connell, Corporate Director, Employee Benefits and H.R. Systems, United Technologies Corporation, and Vice Chairman, ERISA Industry Committee

Good afternoon. My name is Daniel O'Connell. I am Corporate Director, employee Benefits and H.R. Systems for United Technologies Corporation. I also serve as Vice-Chairman of The ERISA Industry Committee, commonly known as "ERICA," and I am appearing before the Subcommittee this afternoon on ERIC's behalf.

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

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

ERIC supports H.R. 1102, and we wish to thank Congressmen Portman and Cardin and their staffs for the vision, wisdom, and commitment that they have displayed in crafting and introducing ground-breaking retirement security legislation. H.R. 1102 makes significant reforms that will strengthen the retirement plans that employers voluntarily provide for their employees and improve the ability of workers to provide for their retirement. ERIC is conducting a detailed study of the provisions of the bill that incorporate changes to previously-introduced legislation and will be pleased to work with the Subcommittee to resolve any technical or other issues that its examination uncovers.

ERIC advocates the speedy enactment of major provisions in the bill that will (1) increase benefit security and enhance retirement savings, (2) increase pension portability, and (3) rationalize rules affecting plan administration.

Improved Benefit Security and Enhanced Retirement Savings

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

The limits originally imposed by ERISA in 1974 allowed nearly all workers participating in employer-sponsored plans to accumulate all of their retirement income under funded, tax-qualified plans. Between 1982 and 1994, however, Congress enacted laws that repeatedly lowered the ERISA limits and imposed wholly new limits. See Attachment A. The cumulative impact of constricted limits has been to reduce significantly retirement savings and imperil the retirement security of many workers.

H.R. 1102 turns this tide at a critical time. This Subcommittee does not need to be reminded that the baby boom cohort is rapidly nearing retirement, and that it is critical for them and for our nation that baby boomers have all the incentives and resources they need to prepare for their own retirement. Retirement planning is a long-term commitment. If we wait until this group has begun to retire, it will be too late. Many employers will not have cash available to pay for rapid increases in pension liabilities, and employees will not have time to accumulate sufficient savings. We must act now. The provisions of H.R. 1102 open that door. It is an opportunity we cannot afford to pass up.

Restoring benefit and contribution limits to more reasonable levels will help employees prepare for retirement at a modest—and short-term—revenue cost to the federal government. In reviewing these provisions, Congress should consider the following:

- Savings accumulated in tax-qualified retirement plans are not a permanent revenue loss to the federal government. Taxes are paid on almost all savings accumulated in tax-qualified plans when those savings are distributed to plan participants and beneficiaries. Workers who save now under most types of plans will pay taxes on those savings when they retire in the future. In 1997, tax-qualified employer-sponsored retirement plans paid over $379 billion in benefits, exceeding by almost $63 billion the benefits paid in that year by the Social Security Old Age and Survivors Insurance (OASI) program. In future years, benefits paid from qualified plans will increase dramatically.[1]
- While retirement savings are accumulating in tax-qualified plans, they serve as an engine for economic growth and thereby indirectly produce additional revenue for the federal government and directly enhance the ability of the nation to absorb an aging population. In 1994, pension funds held 28.2% of our Nation's equity market, 15.6% of its taxable bonds, and 7.4% of its cash securities. In a time of increased concern about national savings rates, retirement plans have been a major source of national savings and capital investment
- Many of today's workers' savings and benefits opportunities are significantly restricted by current limits. Recently, in one typical ERIC company, workers who were leaving under an early retirement program and who had career-end earnings of less than $50,000 had the benefits payable to them under their tax-qualified defined benefit plan reduced by the Internal Revenue Code limits. Recent studies by the Employee Benefit Research Institute of contribution patterns in 401(k) plans indicate that many older workers are constrained by the dollar limits on contributions to 401(k) plans. The qualified plan limits also curtail the efforts of women and other individuals who have gaps in their workforce participation or in their pension coverage to make significant savings in a timely manner.
- Limits imposed on defined benefit plans imprudently delay current funding for benefits that workers are accruing today. Funding is restricted because tax-law limits arbitrarily truncate projections of the future salaries on which benefits will be calculated. As a result, in some cases, the employer is still funding an employee's benefits after the employee has retired. This situation will become more burdensome for plan sponsors as the large baby-boom cohort moves to retirement. One of the major purposes of ERISA was to avert precisely this kind of benefit insecurity.
- The retirement security of all workers is best served when all workers participate together in a common retirement plan, as was the case until recent years. The current system has created a bifurcated world in which business decision-makers (as well as more and more of those who work for them) depend increasingly on unfunded nonqualified plans for the bulk of their retirement savings. Not only does this cause unnecessary complexity in business administration, it diverts energy and resources away from the qualified plans.

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

Restoring limits to more rational levels will be critical to providing retirement security to working Americans in the coming decades. Let me briefly highlight some of the specific provisions that are of particular concern to ERIC members:

The bill (§ 101) *restores the limits on early retirement benefits to more appropriate levels.* The Tax Equity and Fiscal Responsibility Act (TEFRA, 1982) imposed an actuarial reduction on allowable benefits for those retiring before age 62 (subject to a $75,000 floor at age 55 or above). Four years later, the Tax Reform Act of 1986 imposed an actuarial reduction on anyone who retired before Social Security retirement age and eliminated the $75,000 floor for employees retiring at age 55. In 1999, the limit at age 55 is approximately $52,036, more than $20,000 less than the limit set in 1974. The reduction in limits for early retirement will become even more severe as the Social Security retirement age increases to age 67. H.R. 1102 eliminates the requirement for actuarial reductions in benefits that commence between age 62 and the Social Security retirement age.

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

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

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

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

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

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

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

ERIC strongly supports the bill's proposal to reverse the restrictions on savings and return to a $235,000 limit—the limit in effect before the enactment of the Omnibus Budget Reconciliation Act of 1993.

The bill (§ 112) *permits employer-sponsored defined contribution plans to allow employees to treat certain elective deferrals as after-tax contributions.* In 1997, Congress created a new savings vehicle, commonly known as the Roth IRA. Under this savings option, individuals may make after-tax contributions to a special account. The earnings on those contributions accumulate on a tax-free basis, and no tax is assessed on distributions if certain conditions are met. The bill permits employers to offer a similar option within the employer's 401(k) plan.

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

Employees who find the tax treatment of these new accounts attractive will, under the bill's provision, be able to enhance their savings while not losing the benefits of participating in an employer plan. To the extent that individuals who find these accounts attractive are concentrated among the lower-paid, offering such accounts within the employer's 401(k) plan also will help to prevent erosion of the plan's ability to comply with nondiscrimination tests and will preserve the plan and its savings potential for all employees.

The bill (§ 202) *repeals the 25% of compensation limit on annual additions to a defined contribution plan*. Under current law, the maximum amount that can be added to an employee's account in a defined contribution plan in any year is the lesser of $30,000 or 25% of the employee's compensation. H.R. 1102 repeals the 25% limit.

The 25% limit does not have a practical impact on a company's upper echelon employees. For example, for an employee earning $200,000 per year, the dollar limit is lower than the 25% limit. Because of the 25% limit, employers are often forced by the law to limit the contributions on behalf of lower-paid employees, especially employees who take advantage of the savings feature in a § 401(k) plan. Repealing the 25% limit will eliminate this problem.

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

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

INCREASED PENSION PORTABILITY

Employers and employees are increasingly involved in mergers, business sales, the creation of joint ventures, and other changes in business structure.[2] The bill promotes pension portability by eliminating a number of significant stumbling blocks to portability created by current law. The bill will substantially improve employees' ability to transfer their retirement savings from one plan to another and to consolidate their retirement savings in a single plan where they can oversee it and manage it more effectively and efficiently.

The bill (§ 303) *allows an employee's after-tax contributions to be included in a rollover*. Under current law, any portion of a distribution that is attributable to after-tax employee contributions is not eligible for rollover. This rule prevents employees who have made after-tax contributions from rolling over all of their benefits either to another plan or to an IRA. The rule unnecessarily and unwisely reduces the employee's retirement savings, and is inconsistent with the Congressional policy of encouraging employees to preserve their retirement savings. H.R. 1102 allows after-tax money to be included in a rollover to an IRA.

While we applaud the direction set by this provision of the bill, ERIC has proposed that the provision be expanded to allow after-tax rollovers to qualified plans that accept them.

It is important to eliminate the restrictions of current law because they not only are confusing to employees but force them to strip a portion of their savings from their accounts just because the savings were made with after-tax contributions.

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

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

impediments for plan sponsors that might otherwise allow their plans to accept direct transfers from other plans.

The bill resolves this problem by providing that the plan receiving the assets does not have to preserve the optional forms of benefit previously available under the plan transferring the assets if certain requirements are met.

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

The bill (§ 305) *repeals the* § 401(k) *"same desk" rule.* As a result of the sale of a business, an employee may transfer from the seller to the buyer but continue to perform the same duties as those that he or she performed before the sale. In these circumstances, under the § 401(k) "same desk" rule, the employee is not deemed to have "separated from service" and the employee's § 401(k) account under the seller's plan must remain in the seller's plan until the employee terminates employment with the buyer. This prevents the employee from rolling over his § 401(k) account to an IRA or consolidating it with his account under the buyer's plan.

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

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

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

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

Rational Rules for Plan Administration

Superfluous, redundant, confusing and obsolete rules encumber the administration of tax-qualified retirement plans. These rules unnecessarily increase the cost of plan administration, discourage plan formation, and make retirement planning more difficult for employees. We are very pleased that H.R. 1102 significantly advances the work Congress began in earlier bills to strip away these regulatory "barnacles." For example:

The bill (§ 522) *updates the definition of an ERISA "excess" plan.* ERISA provided for "excess benefit plans," that is, nonqualified plans maintained exclusively to pay benefits that have been curtailed by the limits in the IRC. However, in 1974 the IRC included only the limits imposed by IRC § 415.

Since that time, a limit has been imposed on compensation that can be taken into account under a qualified plan [IRC § 401(a)(17)], and several additional limits have been imposed on contributions to 401(k) plans. These new limits have never been reflected in ERISA's definition of "excess benefit plan." The new limits are most damaging to older workers who are at the height of their earning capacity and ability to save for retirement. Many such workers have been unable to set aside sufficient retirement savings earlier in their careers because of family obligations such as housing and education.

Under ERISA, the retirement benefits of top management employees can be supplemented by a "top hat" plan (i.e., a plan for a select group of management or highly compensated employees). However, unless ERISA's definition of an "excess benefit plan" is updated to reflect the new IRC limits, the rapidly increasing numbers of other employees whose benefits are restricted by the IRC limits will see their retirement benefits substantially diminished.

The bill (§ 523) *provides suspension of benefit notices through more appropriate and effective mechanism.* One of the chief impediments to the creation and maintenance of defined benefit plans is their administrative cost and complexity. While some of that complexity is inherent in the design of these plans, much of it is due to excessive and wasteful regulation. The Department of Labor's regulation requiring individual "suspension of benefit" notices is a glaring example of such over-regulation.

Most defined benefit pension plans provide that, in general, benefits do not become payable until the employee terminates employment *even if the employee has attained the plan's normal retirement age (usually age 65)*. See Internal Revenue Code ("IRC") § 411(a)(3)(B) and Employee Retirement Income Security Act ("ERISA") § 203(a)(3)(B).

Pursuant to Department of Labor Regulations, however, a plan may not withhold benefit payments under these circumstances unless, during the first calendar month or payroll period after the employee attains normal retirement age, the plan notifies the employee that his benefits are suspended. The notice must meet complex and detailed specifications. See 29 C.F.R. § 2530.203–3(b)(4). The notice requirement should be changed for the following reasons:

- Employees who continue working past the plan's normal retirement age do not expect to begin receiving benefit payments until they actually retire. Thus, many employees who receive the notice view it as a waste of plan assets. For others, the notice is perceived as a subtle attempt by the employer to expedite their retirement.
- The notice requirement also creates substantial record-keeping and paperwork burdens for employers. Regardless of the number of employees affected, the employer must incur the cost of installing a system to identify and notify each employee who works beyond the plan's normal retirement age or who is re-employed after attaining normal retirement age.
- In spite of the most conscientious efforts by plan administrators to comply with the DOL requirement, errors inevitably occur. Unfortunately, a plan that fails to provide the required notice to even a single affected employee risks losing its tax-qualified status—exposing the plan, the employer, and all of the plan's participants and beneficiaries to enormous financial penalties.

The SPD is the primary vehicle for informing plan participants and beneficiaries about their rights under employee benefit plans. Plans are required by ERISA to supply copies of the SPD to participants and beneficiaries, and participants have been educated to consult their SPD's for information about their benefit plans. As such, the SPD is the most appropriate—and effective—mechanism for delivering information about the payment of benefits to participants.

REDUCED REGULATORY BURDENS

As pension law evolves, ERIC urges that Congress avoid imposing new regulatory burdens on employer-sponsored plans.

The bill (§ 407) *imposes new notice requirements when a change in plan design results in significant reductions in the rate of future benefit accruals.* Under ERISA § 204(h), plans must notify participants in advance of any plan amendment that will result in a significant reduction in the rate of benefit accruals under the plan. ERIC is concerned that any modification of this requirement will add significantly to plan costs, impose requirements that are difficult if not impossible to satisfy, or hinder the ability of employers to adjust their plans to meet changing business circumstances or changing employee needs. Any of these results would defeat the purpose of the amendment by making it more difficult for employers to offer significant retirement savings opportunities for their employees. ERIC will examine the bill's proposal, as well as any other similar proposals that may be put forward and will report to the Subcommittee on its findings.

The bill (§ 501) *changes the way in which the qualification standards are enforced*. Under current law, a plan may be disqualified for failing to meet the Internal Revenue Code's qualification requirements even if the failure was inadvertent and even if the employer has made a good faith effort to administer the plan in accordance with the qualification requirements. ERIC has long been concerned with this serious problem, and it is very appreciative of the interest that the sponsors of H.R. 1102 have taken in this issue.

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

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

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

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

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

ATTACHMENT A

A Historical Summary of Limits Imposed on Qualified Plans

1. IRC § 415(b) limit of $120,000 on benefits that may be paid from or funded in defined benefit (DB) plans. Prior to ERISA, annual benefits were limited by IRS rules to 100% of pay. ERISA set a $75,000 (indexed) limit on benefits and on future pay levels that could be assumed in pre-funding benefits. After increasing to $136,425, the limit was reduced to $90,000 in TEFRA (1982). It was not indexed again until 1988; and it was subjected to delayed indexing, i.e., in $5000 increments only, after 1994 (RPA). RPA also modified the actuarial assumptions used to adjust benefits and limits under § 415(b). The limit for 1999 is $130,000. If indexing had been left unrestricted since 1974, the limit for 1997 would be approximately $218,000.

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

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

4. IRC § 415(c) limit of $30,000 on contributions to defined contribution (DC) plans. ERISA limited contributions to a participant's account under a DC plan to the lesser of 25% of pay or $25,000 (indexed). The $45,475 indexed level was reduced to $30,000 in TEFRA (1982); indexing also was delayed by TRA '86 until the DB limit reached $120,000. RPA restricted indexing to $5000 increments. The 1999 limit is still $30,000. If indexing had been left unrestricted since 1974, the 1997 limit would be approximately $72,500.

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

fined contribution plan and the limit is exceeded solely due to the employee's salary reduction deferrals plus the employer's matching contribution on those deferrals.

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

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

8. IRC § 401(a)(17) limit on the amount of compensation that may be counted in computing contributions and benefits. TRA '86 imposed a new limit of $200,000 (indexed) on compensation that may be taken into account under a plan. OBRA '93 reduced the $235,000 indexed level to $150,000. RPA restricted future indexing to $10,000 increments. The 1999 limit is $160,000. If this limit had been indexed since 1986 without reduction the 1997 level would be $261,560.

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

10. IRC § 401(m)(2) percentage limits on matching contributions and after-tax employee contributions. TRA '86 imposed a new limit on the rate at which contributions may be made on behalf of HCEs. Beginning in the year 1999, section 1433 of Public Law 104–188 eliminates this requirement for matching payments on pre-tax (but not after-tax) elective contributions of up to 6% of pay if those payments follow certain safe-harbor designs.

11. IRC § 402(g) dollar limit on contributions to 401(k) plans. TRA '86 imposed a limit of $7000 on the amount an employee may defer under a 401(k) plan. RPA restricted further indexing to increments of $500. The 1999 indexed limit is $10,000.

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

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

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

LEGEND:

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

ATTACHMENT B

Application of Same Desk Rule to Payments from Tax-Qualified Plans

Type of Plan	Does Same Desk Rule Apply?
Conventional Defined Benefit Pension Plan	No
Cash Balance Pension Plan	No
Money Purchase Pension Plan	No
Profit-Sharing Plan	No
Stock Bonus Plan	No
Employee Stock Ownership Plan	No
Employer Matching Contributions	No
After-Tax Employee Contributions	No
§ 401(k) Contributions	Yes [3]

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

Chairman HOUGHTON. Thank you very much, Mr. O'Connell. Ms. Sears.

STATEMENT OF CAROL SEARS, ENROLLED ACTUARY, CERTIFIED PENSION CONSULTANT AND VICE PRESIDENT, SMALL PARKER AND BLOSSOM, AND PRESIDENT, AMERICAN SOCIETY OF PENSION ACTUARIES

Ms. SEARS. Mr. Chairman, members of the subcommittee, thank you for inviting me today to testify on this important subject. My name is Carol Sears. I am an enrolled actuary, a certified pension consultant and a vice president of Small Parker and Blossom, a pension administration and consulting firm located in Peoria, Illinois. Small Parker and Blossom provides retirement plan services to over 1,000 small businesses located in the midwest. All together, the plans provide retirement plan coverage to over 100,000 small business employees, and I am here to tell you that proposals to expand retirement coverage do play in Peoria. [Laughter.]

I also presently serve as president of the American Society of Pension Actuaries on behalf of whom I am testifying today. ASPA is an organization of over 4,000 professionals who provide actuarial consulting and administrative services to approximately one-third of the qualified retirement plans in the United States. The vast majority of these retirement plans are 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 plans coverage to their employees.

Before getting into the substance of my testimony, I would like to thank the many members of this subcommittee who have taken a leadership role on pension issues. Your efforts really will make a difference.

Everyone agrees on the problem; Americans as a whole are getting older, and their retirement needs are growing. The number of Americans age 65 or older will double by 2030 so that one in five Americans will be retired. As reflected in the current debate, the stress and strain on the current Social Security system will be significant. However, even if the Social Security system remains strong through the 21st century, it will not be enough.

Income from Social Security represents less than half of what the average American needs to retire comfortably. This highlights the need to expand and reform the private pension system. However, this need is especially acute with respect to small businesses. Currently, only 20 percent of small business employees have any retirement plan coverage. By contrast, over 70 percent of workers at largest firms have some form of retirement plan coverage. The Comprehensive Retirement Security and Pension Reform Act contains numerous provisions which, if enacted, would have substantial and immediate impact on small business retirement plan coverage. Throughout my testimony, I will highlight some of the more significant of these provisions.

Believe it or not, there are a number of present law rules which actually work to discourage small business from establishing retirement plans on behalf of workers. One of the most prominent examples of this problem is the top-heavy rules. Both large and small company retirement plans are subject already to non-discrimination rules which work to ensure that benefits are fairly distributed to all employees. However, the top-heavy rules, which are additional requirements on top of these non-discrimination rules, only apply to small business. How much the small business owner makes is not relevant. Even if the small business owner is making only $30,000, the plan can still be considered top-heavy. This problem is made worse when a family member of the owner works in the small business, because the top-heavy rules discriminate against family-owned small businesses by treating all family members as key employees no matter what their salary.

If a plan is top-heavy, small business must make special required contributions which substantially increase the cost of the small business plan. According to a survey of small businesses conducted by the Employee Benefit Research Institute, these required contributions were the number one regulatory reason why small businesses did not maintain a retirement plan for their employees.

The Comprehensive Retirement Security and Pension Reform Act contains several provisions which will bring some sense to the overly burdensome top-heavy rules. In particular, these changes will allow small businesses—even if they employ some family members—to offer a basic 401(k) plan to their employees. It is time to give small business an extra break and not an extra burden.

Since ERISA was enacted, Congress has placed significant limits and caps on retirement plan contributions and benefit. Although these provisions were enacted under the false premise of reducing the benefits of high-paid individuals, they actually serve to reduce the benefits of rank-and-file employees.

Let me tell you a story: an agricultural and trucking shipping company established a defined benefit plan shortly after ERISA for which I was the actuary. The owner spent many years investing and reinvesting income into developing such a capital-hungry company. Since he started this company later in his career, the Defined Benefit Program was a super tool to allow him and his employees to catch up with respect to the retirement benefits and ultimately achieve retirement security. The company once had as many as 50 employees benefiting in the plan. In 1992, Congress reduced the amount of annual compensation that can be taken into account for purposes of accruing retirement benefits. Combined with reductions in the amount of benefits employees can earn, which were enacted in the eighties, the benefits for the owner and the company's other key employees who had helped to build the company were cut by more than half. So, what did they do? They terminated their generous defined benefit plan like so many other similar businesses in the early nineties and replaced it with a 401(k) plan. Since the employer paid completely for the defined benefit plan whereas 401(k) plans are funded with employee contributions, the result was a significant reduction in retirement benefits for rank-and-file workers.

Is this sensible retirement policy? ASPA and numerous other groups certainly do not think so. That is why organizations representing unions, employer groups, and retirement professionals support the increases of these limits in the Comprehensive Retirement Security and Pension Reform Act. Increasing these limits will bring employers back to qualified retirement plans which will provide meaningful retirement benefits for all workers.

We look forward to working with you, Mr. Chairman, and other members of this subcommittee, to move this bill and other positive initiatives through the legislative process.

[The prepared statement follows:]

Statement of Carol Sears, Enrolled Actuary, Certified Pension Consultant and Vice President, Small Parker and Blossom, and President, American Society of Pension Actuaries

INTRODUCTION

Mr. Chairman, Members of the Subcommittee, thank you for inviting me today to testify on this important subject. My name is Carol Sears. I am an enrolled actuary, certified pension consultant, and Vice President of Small, Parker and Blossom, a pension administration and consulting firm located in Peoria, Illinois. Small, Parker, and Blossom provides retirement plan services to over one thousand small businesses located in the Midwest. All together, these plans provide retirement plan coverage to over one hundred thousand small business employees.

I also presently serve as President of the American Society of Pension Actuaries (ASPA) on behalf of whom I am testifying today. ASPA is an organization of over 4,000 professionals who provide actuarial, consulting, and administrative services to approximately one-third of the qualified retirement plans in the United States. The vast majority of these retirement plans are plans maintained by small businesses, and today I would like to focus on the myriad of rules and regulations which continue to make it exceedingly difficult for small businesses to offer meaningful retirement plan coverage to their employees.

THE SMALL BUSINESS RETIREMENT CRISIS

Everyone agrees on the problem. Americans, as a whole, are getting older and their retirement needs are growing. The number of Americans age 65 or older will double by 2030 (from 34.3 to 69.4 million) so that one in five Americans will be retired. As reflected in the current debate, the stress and strain on the current Social Security system will be significant.

However, even if the Social Security system remains strong through the 21st century, it will not be enough. Income from Social Security represents less than half of what the average American needs to retire comfortably. Meanwhile, according to recent surveys conducted by the Employee Benefits Research Institute one-third of the American workforce has not begun to save for retirement, and 75% of Americans believe they do not have enough retirement savings. Americans with low to moderate incomes are hardest hit since they are most likely to have no savings.

This highlights the need to expand and reform the private pension system. However, this need is especially acute with respect to small businesses. Since the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), the Congress has enacted layer upon layer of complex laws, and the Internal Revenue Service (IRS) has issued layer upon layer of complicated regulations seriously retarding the ability of small businesses to maintain retirement plans for their employees. In most cases these rules were enacted not in the interest of promoting retirement savings, but to raise revenue and to fund unrelated initiatives.

The effect of these costly rules and regulations on small business pension coverage is both dramatic and rather disturbing. The facts speak for themselves. According to a 1996 General Accounting Office study,[1] a whopping 87 percent of workers employed by small businesses with fewer than 20 employees have absolutely no retirement plan coverage. It's only slightly better for workers at small businesses with between 20 and 100 employees, where 62 percent of the workers have no retirement coverage. By contrast, 72 percent of workers at larger firms (over 500 employees) have some form of retirement plan coverage.

This significant disparity is made even more troubling by the fact that small business is creating the majority of new jobs in today's economy. As big firms go through corporate downsizing, many of the displaced workers find themselves working for small businesses. In fact, according to the Small Business Administration, 75 percent of the new jobs in 1995 were created by small business. Small business now employs over half of the nation's workforce. However, because of the many impediments to small business retirement plan coverage, small business employees will often find themselves without a meaningful opportunity to save for retirement.

The Comprehensive Retirement Security and Pension Reform Act (H.R. 1102), introduced by Congressmen Portman (R–OH) and Cardin (D–MD), and co-sponsored by you, Mr. Chairman, Congressmen Lewis (D–GA) and Weller (R–IL), and several other members, contains numerous provisions which, if enacted, would have a substantial and immediate impact on small business retirement plan coverage. Throughout my testimony I will highlight some of the more significant of these provisions.

ROADBLOCKS AND SOLUTIONS TO SMALL BUSINESS RETIREMENT PLAN COVERAGE

1. Top Heavy Rules

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 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. One of the most prominent examples of this problem is the top-heavy rules.

The top-heavy rules are not relevant for large firm (over 500 participant) plans. They only affect plans maintained by small business. The top-heavy rules look at the total pool of assets in the plan to determine if too high a percentage (more than 60%) of those assets represent benefits for key employees, namely the owners of the small business. How much the small business owner makes is not relevant. Even if the small business owner is making only $30,000, the plan can still be considered "top-heavy." Because it is a small business, the likelihood of a small business plan being top-heavy is greater because you are spreading the pool of plan assets over a smaller number of workers. This problem is made worse when a family member of the owner works in the small business because the top-heavy rules discriminate against family-owned small businesses by treating all family members as key employees no matter what their salary.

If a plan is top-heavy, the small business must make special required contributions which substantially increase the cost of the small business plan. According to a survey of small businesses conducted by the Employee Benefit Research Institute, these required contributions were the number one regulatory reason why small businesses did not maintain a retirement plan for their employees. For example, in the case of a 401(k) plan that is considered top-heavy, the small business owner is generally required to make a 3% of compensation contribution on behalf of every employee. This is not a matching contribution; the 3% of compensation contribution

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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).

has to be made regardless of whether the employee saves into the plan. In fact, even if the small business owner chooses to offer matching contributions to employees, under IRS regulations the matching contributions will not count toward satisfying the top-heavy minimum contribution requirement. As a result of the top-heavy rules, the cost per participant to the small business owner maintaining a 401(k) plan can be more than double the cost per participant to the large firm.

Simply put, the excessive fascination with doctors and lawyers has left the majority of small business employees out in the cold with respect to retirement plan coverage. The Comprehensive Retirement Security and Pension Reform Act contains several provisions which will bring some sense to the overly burdensome top-heavy rules. In particular, these changes will allow small businesses, even if they employ some family members, to offer a basic 401(k) plan to their employees. It's time to give small businesses who want to provide retirement benefits for their employees an extra break not an extra burden.

2. Retirement Plan Limits

Since ERISA was enacted, Congress has placed significant limits and caps on retirement plan contributions and benefits. Although these provisions were enacted under the false premise of reducing the benefits of high-paid individuals, they have actually served to reduce the benefits of rank-and-file employees.

Let me tell you a story. An agricultural trucking and shipping company established a defined benefit plan shortly after ERISA for which I was the actuary. The owner had invested a lot of years in the late 60's and early 70's investing and reinvesting income into developing such a capital hungry company. As he had spent many years as a trucker and had started this company later in his career, the defined benefit program was a super tool to accumulate retirement benefits that fit his and his devoted and older employees' life style maintenance needs in the time remaining before their retirement. He established the plan in the late 70's. He once had as many as 50 employees benefiting in the plan. In 1992, Congress reduced the amount of annual compensation that can be taken into account for purposes of accruing retirement benefits from $235,000 to $120,000. Combined with reductions in the amount of benefits employees can earn, which were enacted by Congress in the 80s, the benefits for the owner and a few devoted employees were cut by more than half.

So what did they do? They terminated their generous defined benefit plan, like so many other similar businesses in the early 90s, and replaced it with a 401(k) plan. Since the employer paid completely for the defined benefit plan, whereas 401(k) plans are funded with employee contributions, the result was a significant reduction in retirement benefits for rank-and-file workers. So what about the owner and few devoted employees? They made up for the loss of defined benefits by adopting a special retirement plan, called a "nonqualified top-hat plan." Unlike a traditional qualified defined benefit plan, a nonqualified top-hat plan does not have to provide any benefits to rank-and-file workers and is not subject to any of the limits on contributions and benefits. Even though the business does not get to currently deduct the value of these benefits, from the perspective of the executives, these benefits receive essentially the same tax preference as benefits under a traditional qualified plan (i.e., they are taxable when distributed).

Is this sensible retirement policy? ASPA and numerous other groups certainly do not think so. That is why organizations representing unions, employer groups, retirement professionals, and the Pension Benefit Guaranty Corporation support the increases of these limits in the Comprehensive Retirement Security and Pension Reform Act. Increasing these limits will bring employers back to qualified retirement plans, which will provide meaningful retirement benefits for all workers. The tax benefits granted to qualified plans, as opposed to nonqualified plans, help subsidize the benefits of rank-and-file workers. Increasing the limits on retirement plan contributions and benefits is a win-win for both employers and workers.

3. Impediments to Defined Benefit Plan Coverage

a. Full Funding Limit. The present-law funding limits, for defined benefit plans, are a prime example of how overbroad legislation can have a disastrous effect on small business retirement plan coverage. In 1987, the full funding limit—the limit on the amount an employer is allowed to contribute to a defined benefit plan—was substantially reduced. The changes were made solely to raise revenue and had nothing to do with retirement policy. As an actuary, I can tell you that the current law full funding limit seriously impairs the funded status of defined benefit plans and threatens retirement security because it does not allow an employer to more evenly and accurately fund for projected plan liabilities. One way to conceptualize the problem is to compare a balloon mortgage to a more traditional mortgage which is amortized over the term of the loan. The full funding limit causes plan funding to work more like a balloon mortgage by pushing back necessary funding to later years. This is particularly harsh on small business because a small business does not have the cash reserves and resources that a large firm has, and so would be better off if it could more evenly fund the plan. Even worse for small business, a special rule in the Internal Revenue Code relaxes the full funding limit somewhat, but only for larger plans (plans with at least 100 participants). Once again this appears to be a vestige of the view that small business plans are just for doctors and lawyers.

Small business owners are aware of the present-law funding limits on defined benefit plans, and that is why small businesses with defined benefit plans are trying to get rid of them and new small businesses are not establishing them. From 1987, when the full funding limit was changed, to 1993—a period which saw a significant increase in the number of small businesses established—the number of small businesses with defined benefit plans dropped from 139,644 to 64,937.[2] That is over a 50 percent decline in just seven years.

To reverse this trend, ASPA strongly believes that the full funding limit should be repealed to allow for more secure funding. Repeal of the full funding limit is supported by wide variety of organizations representing the entire spectrum of views pertaining to retirement policy. Repeal is supported by organizations representing unions, participants, employers, financial institutions and retirement professionals. It is also supported by the Pension Benefit Guaranty Corporation, which as you know is responsible for guaranteeing workers retirement benefits.[3]

The repeal of the full funding limit is included in the Comprehensive Retirement Security and Pension Reform Act, as well as the Retirement Accessibility, Security, and Portability Act of 1998 (H.R. 4152), introduced last year by Congressmen Gejdenson (D–CT), Neal (D–MA), Gephardt (D–MO), and numerous others.

b. Reduced PBGC Premiums for New Small Business Plans. Imagine if you had to pay premiums on a life insurance policy based on a $100,000 benefit, but that the policy only paid a $50,000 benefit. No sensible consumer would purchase such a policy. However, that is in fact what often occurs when a small business adopts a new defined benefit plan.

Let me explain. If a newly created defined benefit plan gives credit to employees for years of service prior to adoption of the plan, the tax code funding rules limit, in the early years of the plan, how much can be contributed to the plan to fund the benefits associated with this past service credit. Consequently, the new plan is treated as "underfunded" for PBGC premium purposes and the plan is subject to a special additional premium charged to underfunded plans. This premium is assessed even though the premium is based on benefits which exceed the amount the PBGC would pay out if they had to take over the plan. In other words, the small business is forced to pay premiums to insure benefits that exceed what the PBGC will guarantee.

This additional premium can amount to thousands of dollars and is a tremendous impediment to the formation of small business defined benefit plans. Fortunately, both Congress and the Clinton Administration have recognized this problem. The President's pension proposals, introduced by Congressman Neal (D–MA), and the Comprehensive Retirement Security and Pension Reform Act include a provision that would reduce PBGC premiums for new small business defined benefit plans to $5 per participant for the first five years of the plan. Given the pressing need to expand pension coverage for small business employees, particularly defined benefit plan coverage, ASPA hopes this legislation can be enacted as soon as possible.

4. Other Proposals Expanding Small Business Retirement Plan Coverage

I would like to highlight some other provisions in the Comprehensive Retirement Security and Pension Reform Act, as well as other legislation that, if enacted, would lead to expanded small business retirement plan coverage.

a. Allowing Catch-up Contributions for Spouses Returning to the Workforce. Under present law, contributions to defined contribution plans, like 401(k) plans, are limited to the lesser of 25% of compensation or $30,000. Furthermore, under present deduction rules an employer may have to reduce contributions, like matching contributions, it makes on behalf of an employee because the employee saves too much of his or her own wages. In many cases a spouse returning to the workforce after helping to raise a family, who is working part-time or is lower paid, cannot save

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

[3] The Advisory Council on Social Security also urged in its report that the full funding limit be modified to allow better funding of private pension plans. Report of the 1994–1996 Advisory Council on Social Security, *Volume I: Findings and Recommendations* 23 (January 1997).

sufficiently for retirement because of the 25% of compensation limitation and the deduction rules. For example, a spouse making $20,000 on a part-time basis can presently only save $5,000 a year, including both employee and employer contributions. Because of other resources, he or she may want to save a greater percentage of this income to ensure a more secure retirement. Part-time and lower-paid workers should be able to save a greater percentage of their compensation if they choose to do so. Provisions in the Comprehensive Retirement Security and Pension Reform Act would correct this problem. Also, a provision in Congresswoman Dunn and Congressman Weller's "Lifetime Tax Relief Act of 1999," H.R. 1084, to allow special homemaker 401(k) contributions would assist with this problem.

b. Tax Credit for Start-up Costs. According to surveys of small businesses, high administrative costs are one of the chief reasons small businesses do not adopt a retirement plan. A provision in the Clinton Administration's budget and the Comprehensive Retirement Security and Pension Reform Act would greatly alleviate this problem. A 50% tax credit would be given for administrative expenses incurred in connection with a new small business plan. The credit would be for expenses up to $2,000 for the first year and $1,000 for the second and third years.

c. Simplified Defined Benefit Plan for Small Business. As noted earlier, the costs associated with interpreting and applying the regulations governing retirement plans 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.[4] However, the cost per participant for a small business defined benefit plan can often be twice that amount.

In 1996, Congress enacted a simplified defined contribution plan for small business called the SIMPLE plan. However, many small businesses would like to offer a defined benefit to their employees, but are impeded by high administrative costs. The Secure Assets for Employees (SAFE) Plan proposal, introduced by Nancy Johnson (R–CT) and Earl Pomeroy (D–ND), would offer small businesses such a defined benefit option. ASPA believes that small business needs a simplified defined benefit plan, like the SAFE plan, to complement the SIMPLE plan.

d. Plan Loans for Small Business Owners. For no apparent policy reason, many small business owners are currently not permitted to obtain plan loans from their retirement plan like their employees can. Plan loans to the small business owner are only permitted if the small business is incorporated under Subchapter C of the Internal Revenue Code. As you know, for business reasons many small businesses choose to operate as a Subchapter S corporation, partnership, or limited liability company. Retirement plan rules should not be dependent on the form of entity. The Comprehensive Retirement Security and Pension Reform Act contains a provision which allows plan loans to owners regardless of their form of ownership.

e. Roth 401(k) and 403(b) Plans. The Comprehensive Retirement Security and Pension Reform Act includes an innovative provision which allows 401(k) and 403(b) plan participants to choose their tax treatment. Under the proposal participants could choose to treat their contributions like contributions to a Roth IRA (i.e., as after-tax contributions not included in income when distributed if held for five years). ASPA believes this exciting new proposal will encourage many small businesses to offer these plans to their employees, and we support its enactment.

Conclusion

As early as President Carter's Commission on Pension Policy in 1981, there has been recognition of the need for a cohesive and coherent retirement income policy. ASPA believes there is a looming retirement income crisis with the convergence of the Social Security trust fund's potential exhaustion and the World War II baby boomers reaching retirement age. Without a thriving pension system, there will be insufficient resources to provide adequate retirement income for future generations. In particular, four elements have converged to create this crisis:

- The baby boomer population bubble is moving inexorably toward retirement age.
- Private savings in the United States has declined dramatically.
- Many employees, particularly small business employees, continue not to be covered by qualified retirement plans.
- In the absence of major changes, our Social Security system is headed for bankruptcy.

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

During the years 2011 through 2030, the largest ever group of Americans will reach retirement age. Without a change in policy or practice, many in this group will find themselves without the resources to be financially secure in retirement. Most pension practitioners will tell you that the constantly changing regulatory environment has created more complexity than most employers are willing to bear; consequently, coverage under qualified retirement plans has dropped. The problem has affected small businesses most severely—they have fewer resources to pay the compliance costs and must spread those costs over fewer employees. During the early decades of the next century, the ratio of workers to retirees will be significantly lower than it is today. The shrinking ratio of workers who pay Social Security to those drawing benefits makes it likely that future retirees will have to rely more on individual savings and private pension plans and less on Social Security.

We believe there is need for constructive pension reform, particularly with respect to small business retirement plan coverage. We believe the time has come to enact legislation like the Comprehensive Retirement Security and Pension Reform Act, which will provide an opportunity for all working Americans, including small business employees, the opportunity to obtain financial security at retirement. We look forward to working with you Mr. Chairman, and the other members of the subcommittee, to move this bill and other positive initiatives through the legislative process.

Chairman HOUGHTON. Thank you very much, Ms. Sears.

All right. Let me ask the members of the group here, Mr. Stein has to leave to catch a plane, and so if you have any specific questions you would like ask Mr. Stein, I think the best thing to do is to ask them now, and, if not, then you are off the hook. [Laughter.]

Would you like to ask Mr. Stein a question; you don't have to.

Mr. PORTMAN. I would be delighted. You have to leave?

Mr. STEIN. Yes.

Mr. PORTMAN. OK, first of all, for the whole panel, I would love to have a chance to meet later, Mr. Chairman, to talk about some of the specific issues you all raised.

Mr. Stein, I appreciate your input. The suggestion that you make, that plan enhancements, such as increasing the 415 limits should only be available to plans that offer very high minimum benefits, is an interesting idea. What we have heard from the real world—and, again, some of these folks are in the real everyday world working with these plans—is that it just isn't going to work. They aren't going to be interested in those kinds of plans. This is a voluntary system as you said and as others have commented today, and to the extent that it is voluntary, it is got to be attractive. So, those kinds of ideas—and we have gone back and forth, with the simple plan, and so on over the last few years, and have put together constructs where people actually use these plans rather than just, as someone said earlier, create another plan that might be complicated.

As you know, we have been under some pressure here to modify significantly the non-discrimination rules; we have not done that, and that should be made clear for the record that with all these changes we are talking about of increased contribution limits, the non-discrimination rules continue in place with the theory—as you stated in your testimony—that you make the plans more attractive, but then you force the lower paid workers to be part of this plan. That stays in place. And, again, this is a bipartisan effort; has been from the start, and that may be the reason that issue has been broached, but we have never gone that far.

My question to you is on your specific comments—and I am sorry I don't have your testimony right in front of me here—where you talked about what you thought the impact would be of the 401(k) limit being increased. So long as you believe in the non-discrimination rules, which I assume you do, and their beneficial impact, why do you think that would happen?

Mr. STEIN. Well, the 401(k) plans, particularly, after the last Congress, I think essentially exempt some 401(k) plans from meaningful non-discrimination rules, and when you are looking at a—

Mr. PORTMAN. Sorry, say that again.

Mr. STEIN. 401(k) plans and simple plans I think have much reduced and——

Mr. PORTMAN. SIMPLE plans have had regulations reduced, because there are mandatory employer contribution requirements; 401(k)s are still subject to testing, and again, the private sector should speak out, but they tell us all the time, this is a real problem. The testing is a real problem for them in terms of costs, administration, and so on.

Mr. STEIN. I think a lot in this bill will reduce the discrimination requirements in section 401(k) plans, and——

Mr. PORTMAN. A lot in this bill will?

Mr. STEIN. You have the safe harbor 401(k) plans now.

Mr. PORTMAN. Yes, you have those now, but that is not this bill.

Mr. STEIN. You also have in this bill contribution is an automatic contribution plan with an opt-out, which will be in a safe harbor.

Mr. PORTMAN. Are you talking about the salary reduction only simple plan?

Mr. STEIN. Yes, and I think there is——

Mr. PORTMAN. There, again, you have to meet all the criteria.

Mr. STEIN. There is another provision in the bill which does a similar thing, I think, would mend 401(k)——

Mr. CHAMBERS. He is talking about the automatic contribution.

Mr. PORTMAN. OK, the automatic contribution.

Mr. CHAMBERS. The negative election.

Mr. PORTMAN. OK.

Mr. STEIN. Yes, the negative election, doesn't have the minimum contribution requirement or a match requirement, and I think the problem you have there is——

Mr. PORTMAN. I think it does to get that treatment, but anyway, let us focus on what we know is in the plan which is the increase on compensation taken into account because you raised some very serious concerns about that. My question to you is, do you think that that is really going to gut the non-discrimination rules? As you know, we have thought a lot about this; we think there are a few reasons why this would work better for people who make around $80,000 and then young workers making around $40,000 who expect to get up there by the end of their careers; that was what we were focusing on.

Mr. STEIN. I started as a pension attorney and I know that law firms will be writing letters to their clients if this bill passes saying, "Great news. If you are making more than $160,000 now, you can still contribute what you are contributing for yourself and reduce the cost by reducing benefits for lower paid employees."

I have here, a pamphlet published by the Research Institute of America, "A Complete Guide to Age-Weighted Defined Contribution Plans." It talks about the benefits of these kinds of age-weighted defined contribution plans. In my testimony, I gave some examples where a highly compensated employee could make a $30,000 contribution for himself and as a little as a $500 contribution for his lower paid worker. This book says the advantage of the age-weighted allocation formula includes the following: to the extent that the highly compensated participants are also the older participants, age-weighting can maximize the contribution shares of the highly paid. Looked at another way, the overall plan costs associated with providing the highly paid with the maximum contribution can be lowered, and the costs they are talking about there are the costs for the non-highly compensated employees.

I know from experience, when I was in practice, that small employers would come to us, the firm I work for, and say, "I would like to set up a plan and put in as little as possible for my lower paid employees, because they would rather have cash and as much as possible for me. How do I do that?" And it was our job to figure that out. Most of the people in this room who have experience in the area do this for a living, and I think the problem with 401(k) plans, they are great if people would use them, but lower income people and moderate income people find it difficult to save, because they have immediate cash needs, and also the tax incentive for them to use the 401(k) plan, if you have a 15 percent marginal tax rate, is very low. So, in a sense, you have a higher Government match for highly compensated employees.

Mr. PORTMAN. I would just ask, if you could make that booklet a part of the record.

[The information was not received at the time of printing.]

Mr. PORTMAN. Is that in response to the legislative proposal before us today?

Mr. STEIN. No, no, this is existing age-weighted, profit-sharing plans.

Mr. PORTMAN. OK. All right, so that has been critical of existing 401(k) plans with the non-discrimination rules in place. I would just suggest—because my time is up—maybe we can continue this dialogue later through correspondence if you are not in town. The focus on the limits that you talked about in your testimony, the $160,000 to $235,000. First of all, to the extent you believe that those limits were right initially—and maybe you don't; maybe you are criticizing the existing system, it doesn't even keep up with inflation, which is true with all these limits. Incidentally, when you look back at them, and we didn't get a chance to talk about that with Treasury but when you adjust them for inflation, most of them aren't up to the point where they would have been in 1982. But second, our focus is not on the high paid worker actually; it is on the people who get impacted most by that, which tends to be the folks who are middle managers primarily and younger people primarily. I am sorry I took so much time, Mr. Chairman.

Chairman HOUGHTON. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. Mr. Stein, I have one brief question for you. All of the witnesses have indicated that we ought get to rid of the top-heavy rules, and I wonder what you think about that suggestion relative to rank-and-file workers?

Mr. STEIN. Well, I agree that top-heavy rules are complicated, and, ironically, I think H.R. 1102, actually makes it a little bit more complicated. What the top-heavy rules do in some kinds of plans—401(k) plans now, age-weighted, profit-sharing plans—is they ensure that employees are going to get something. If you take them away, there will be some employees who now get something, who will get nothing.

Now, there are other ways to give them something which wouldn't require, I think, the complicated top-heavy rules, but, I worry that this bill starts on a path which I think will eventually lead to the elimination of top-heavy plan rules without substituting some other mechanisan to deliver benefits to lower-paid workers. The policy question here is, whether the complexity of the section 416 rules is such that we should reduce benefits for some people who are getting them now because of the rules and wouldn't get those benefits if we eliminate the rules.

If you are the employee who is now getting a 3 percent contribution and it turns out that you get almost no contribution or smaller than three percent, you won't be very happy if those top-heavy rules are taken away.

Mr. COYNE. Thank you.

Chairman HOUGHTON. Well, thanks very much. Give our best to your children.

Mr. STEIN. Well, thank you. My dog needs to be walked too. [Laughter.]

Chairman HOUGHTON. I would like to ask sort of different type of question, and I would like to ask Ms. Heinz. You were talking about women moving in and out of the workforce, and, obviously, this is a problem, and I think that you said something to the effect that 15 percent of a woman's time is out of the workforce as compared to 2 percent of a man's time. There have been a variety of different suggestions, sort of, catch-up plans and things like that. What do we do about this?

Ms. HEINZ. Well, I think some things have been done in terms of reducing the amount of years required to be able to vest. They used to be, I think, five years, and I think, as I remember, the average time a woman worked was three and one-quarter, something like that, so most of those women failed to get something. And we have held hearings around the—hearings, they are not hearings—but, anyway, meetings around the country on this issue and had testimony from all kinds of women, and without a doubt, you come out feeling—I am not blaming—this is not obviously thought about by the men—it is just part of our evolution in the workforce and our evolution in the economy and our evolution in society. The point is we haven't caught up with the changes, and, on the one hand, we are telling women that they should save, and we are expecting—and Americans, not just women—Americans that they should save more, and they should plan for the three-legged stool to be a healthy one. On the other hand, we haven't had the opportunity to save. Indeed, in 1996, in Boston, we held the first one of these hearings, and Senator Moseley-Braun, together with members of the Massachusetts house and senate, republicans and democrats, women, did such a hearing, and, as a result of this hearing, and not knowing that homebound women could only invest $250 and not $2,000, Carol Moseley-Braun came back and changed that, and within six weeks it changed. It was simple to do, because it made sense. But women up till then were not allowed to vest more than $250 if they didn't work outside of the home even if they had the money to do it.

So, there are a lot of inequities which I think because of intended consequences almost, and I think we have to reevaluate and give different choices to different types of businesses and difference situations for women and men, and I think, indeed, with the world economic situation being what it is, one of the things I noticed in 1996 when I was campaigning was that there were a lot of similarities between our western Pennsylvania and western Massachusetts. For instance, with the demise of a lot of industries because of unfair, very often, trade practices, I think the men are beginning to get hit with some of the things that women have been hit with for a long time for other reasons. So, I think it is incumbent upon us to look at this in a new light.

Chairman HOUGHTON. All right, thank you very much. And, now, Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. Mrs. Heinz, thank you for agreeing to appear here today——

Ms. HEINZ. You are welcome.

Mr. COYNE [continuing]. Before the committee and for the important contribution your organization has made to our study of women's pension issues. In 1998, the Heinz Foundation conducted a national poll on women's savings and pensions, as you know, and it appears to be a highly comprehensive look at the issues before us, particularly as they pertain to African-American and Hispanic women. I want to personally thank you for the leadership you have exhibited to this issue and ask for your help once again here today.

As this committee considers what legislative steps it can take to improve retirement security for women, I was wondering if your foundation would be willing to undertake a similar or even more comprehensive poll on women's pension issues in this year of 1999?

Ms. HEINZ. Sure, would the focus be the same as the former study we did with Sun Corporation?

Mr. COYNE. Yes.

Ms. HEINZ. Same thing with additional questions, additional—I mean, you are trying to get the same questions answered a year later?

Mr. COYNE. That is right.

Ms. HEINZ. All right. Sure, actually, we have done other polls where we have done it two years apart. We did polls in 1996 on other issues which we repeated last year.

Mr. COYNE. Well, being that this issue is before us——

Ms. HEINZ. We could, absolutely. We could ask Sun Corporation to see if they want to co-sponsor it with us.

Mr. COYNE. Well, it would be helpful to this subcommittee and the Full Committee.

Ms. HEINZ. Absolutely, no problem.

Mr. COYNE. During the last few years, your foundation has held conferences in various parts of the country, and in that effort, you have educated women about pension savings and retirement security, and I was just wondering if you were considering any of those meetings or forums for Pittsburgh and western Pennsylvania?

Ms. HEINZ. I have an interest in looking both at places in the country where there is an awful lot of young people and places in the country with an awful lot of older people, maybe Florida, Arizona. I think, generally speaking, people are better off even though there is a big senior population, but it might be interesting. But I think it would be important to try and study both how people look at issues when they are younger and think they will live forever and be healthy forever, and also particularly in older cities, like Pittsburgh and Boston and New York, et cetera, where a lot of the infrastructures, including families and institutions, buildings, everything is kind of falling apart at once, and a lot of jobs are being lost.

So, I think that there are different things happening; there are different pictures, but I think we should study them and see what kind of different packages we can come up with for different needs in the country, and I think the needs are different. But we would be happy to study this along with you if you just let us know.

Mr. COYNE. Thank you. I was struck by part of your testimony where you stated, and I quote, "No one, Republican or Democrat, should take the voting power of women for granted. Economic security now and in old age are issues that women think about and vote about." Do you think that the retirement security issues we are considering before the committee this year are important enough to women to draw them into the political process even if they have never voted before or vote only occasionally?

Ms. HEINZ. I think so. You know, we did—out of the book, which was initially funded by the foundation, called Pensions in Crisis, was written for women, at least initially, and out of that, Good Housekeeping was so amazed by it that they asked to have a little pamphlet made, 16 pages, which we did, and we got some funding from Morgan Stanley and other people to be able to put this on every single Good Housekeeping last year. I also sent this to every Senator and to every spouse; to every Governor and every spouse with this copy, and I have had tremendous bipartisan interest. Trent Lott asked me to go down to Mississippi to do a hearing and have women listen to this.

But to answer your question, we have been doing—Cindy Hounsell, who is here, who runs WISER, has been going to Atlanta, for instance, to work with women, African-American women as a test, and after doing seminars using this very simple, very understandable material, there was some hearings done, I think, funded by Pew in Atlanta, and 400 of these women who had been going to these hearings showed up for this thing, and people do—you want them all there—they all came in; they all signed their name in; they all asked questions. These were African-American women knowing that they had certain rights, not necessarily specific, but that they should ask for certain things, and they were becoming educated, and I think that one of the most brilliant testimonies, by the way, that I heard was in Oregon, the State Treasury in Oregon. There was an African-American gentleman, and he came to our conference, and he spoke, after our women testimony, about his mother. When he was a little boy sitting at the kitchen table, and he was an only child and his father had died, and every week she used to pay the bills and put some money in an envelope, and that was the put-away envelope, and this little boy learned from young to put away. And what he is trying to do in Oregon, which is amazing, is create a credit card for little—not a credit card, but a card for little kids, so that every kid in the State that saves has this little card. It is an incentive to begin to understand savings and investing.

So, there are a lot of things one could do. Some of them we have been taught when we were little, and others we have to orchestrate it, because a lot of people don't understand. But I think that women pretty much understand that they are poor when they are poor, and what has been really scary in these hearings is to see women who were not ever poor, and their husband retired—they are married—and their husband dies; they didn't think the husband would die earlier, and these women are left sometimes poor for the first time in their lives, and that is quite shocking when you see that, because this is a lot Americans; it is a lot of mothers; it is a lot of people my mother's age, your mother's age. It is a reality.

Mr. COYNE. Thank you.

Ms. HEINZ. You are welcome.

Mr. PORTMAN. [presiding] Thank you, Mr. Coyne.

Mr. COYNE. Thank you.

Mr. PORTMAN. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman in waiting. [Laughter.]

Mr. PORTMAN. We have got a long time. [Laughter.]

Mr. NEAL. A follow up with Mrs. Heinz, and, incidentally, I campaigned with her in western Massachusetts; pretty good campaigner. Who was that guy we were campaigning for?

Ms. HEINZ. Never mind. [Laughter.]

Mr. NEAL. My bill, which I am carrying for the administration, would include family and medical leave toward pension credit. People could earn the same pension benefits during family and medical leave, which I think has been a terrific success. Maybe you could respond to that initiative, and any other panelists if they would care to?

Ms. HEINZ. I am not an expert in any way on actuarial businesses, but I thought that in a simple fashion—or simplistic, I should say—that for every hour worked a person should have an hour recognized. How you manage that, I don't know, but if a woman can only work 15 hours a week, because that is all the time she has, and she needs that 15 hours worth of money, she should be able to vest. I don't know the mechanism of doing that, but I think if we are to give people credit for the work, I think we should acknowledge it in all of its benefits. Likewise, I think if a person has only $15 worth of hours a week, they should get 15 hours worth of whatever other benefits they should accrue.

So, I think that there are many ways in which you can do this. I don't know, because regulations are so difficult, and the morass of managing this is so awful that I think people are really—there is a disincentive to people to save and even to work, because why?

Mr. NEAL. Mrs. Sears?

Ms. SEARS. Thank you. ASPA would support such an idea. I think there is an example already out there with USERRA, for military service. I think it would have to be appropriately crafted so that the leave, of course, wasn't completely open-ended. With the correct assumption that that could be done, it certainly makes sense to allow reasonable family and medical leave to count toward vesting eligibility.

Mr. NEAL. Others care to take a—?

Mr. O'CONNELL. The concept is one that sounds equitable. The only caution I would raise from the perspective of an employer trying to administer the provision is that it might impose difficult administrative burdens. It could be a very costly feature to try and keep track of qualifying breaks in service. Not that the concept isn't worthy, but it could be very difficult to make it work.

Mr. CHAMBERS. I would just say that APPWP has not yet had a chance, of course, to look at this and to think it through. Again, I agree that there are some administrative burdens that could come out of this, but I also believe that it is on our agenda for this Thursday, and so we will be discussing it, and we look forward to working with you and anyone with who you might point us to think through this position.

Mr. NEAL. Well, if you vote affirmatively, call me. [Laughter.]

Mr. PORTMAN. Thank you, Mr. Neal. We have a little bit of time left before the vote. Mr. Houghton is rushing over so that he can rush back so the next panel doesn't have to wait at least too long. He should be back probably within 5 or 10 minutes.

If I could follow-up with a few of the questions that have come up. First, just for the record, because we talked about the top-heavy rule, I think it is important to note that H.R. 1102 does not eliminate the top-heavy rules. There has been discussion of that, as you know, and there are a lot of people, including in this room, probably, who think they ought to be eliminated, and that is certainly a major simplification, but we have not done that. There are some modifications. Mr. Stein characterized them a certain way; I would say that they are, indeed, a simplification, but they are in there. The top-heavy rules are retained as are the non-discrimination rules.

Mr. Stein talked about the automatic contribution trusts, and just to get this on the record—I wish he were still here—but, yes, indeed, under the 1998 IRS revenue ruling, we expand that, really codify that and say that an employer can treat an employee as having elected a 401(k) if it is offered and that person doesn't say one way or the other. This has been great to get lower paid employees into 401(k)s which is, of course, a major challenge I hope we are focused on.

What we say in our bill is that you can then get out of some of the non-discrimination testing under certain circumstances. Number one, at least 70 percent of the eligible non-highly compensated employees must actually make 410(k) contributions. Again, that is very positive, and that is to get lower paid folks into the system; that is a big challenge, including, significantly, women and minorities who tend to be in the lower paid jobs and in the industries that have fewer pension plans.

An employer must make a 50 percent matching contribution with respect to the 401(k)s, up to 5 percent of the pay. There is an alternative, you can make 2 percent nonelective. They must be immediately vested. Employees must receive timely notices of rights and so on. So, I think this is the way we ought to be going if we are truly concerned about expanding pensions and getting folks in the system. I just want to put that on the record, because it was referenced in Mr. Stein's give and take.

Thank you for all the work you have done, Mrs. Heinz, on information, and I know last time we had you here—I think at Mr. Coyne's request—you actually gave us all the pamphlet. Many of us took it to heart, and you mentioned in your testimony—and it hasn't been talked about enough today—the importance of information, strictly information, even about what is out there now and the lack of knowledge of so many of my constituents about what is out there. It is amazing to me at my town meetings and so on and the importance of this for their own retirement savings. So, that little pamphlet you talked about actually has made a huge difference because of its distribution, and whatever you can give us in the future on——

Ms. HEINZ. If you are interested, I can make them available. I mean, Labor has ordered I think 2 million and some beyond the 45 million that are being distributed through magazines and others, and several of the governors have asked for copies and other people.

Mr. PORTMAN. It might be helpful—again, Mr. Coyne said, we are at this again. I mean, it is perennial around here; things come up, and sometimes they don't go anyplace as this issue didn't really move last year. This year, I think it will move in one way or another. It might be helpful to get that back out around to the members and, as you said, spouses, and thanks for your help on supporting the expanding small business plans, faster vesting.

The catch-up provisions, you didn't really get a chance to talk about much, but I know how you feel about that, and I think this would help everybody, as you indicated. It will particularly help, I think, women who have been out of the workforce for whatever reason, primarily, raising children, I think, and then can come back in just to get enough of a nest egg during a shorter period of time. That is our idea there.

The portability issue you talked about, that is true with all workers, but, as you said, also very true, particularly, with women.

I am told I have got to run here. APPWP has helped us a lot; we want to thank you for all the work you have put into it. I would love to get you to respond in writing to the contribution limits issue, the specific issue of what the impact of restoring contribution limits will mean to plans, because we heard from Treasury on that; we heard from Mr. Stein on that, and you addressed it, but if you could address, specifically, the concerns raised by Treasury, that would be great.

ERIC, again, you have been very helpful. On this lost revenue issue, I appreciate that additional—again, it is something we haven't talked about yet, but this is not income lost forever, number one, and, number two, the benefits to the economy are clear.

Ms. Sears, ASPA, I am glad it is playing in Peoria; I hope it is playing in Pittsburgh and Cincinnati. People kind of gloss over sometimes when you get into stuff like this, and yet it so important to retirement security, and so I hope you are right, because only with some pressure grassroots, frankly, are we going to get this done, and I appreciate all the work ASPA has put into this.

We are going to go run and vote, and this panel is excused. The hearing will be in recess until Mr. Houghton returns. Thank you all very much for your help.

[Recess.]

Chairman HOUGHTON. Could we have the next panel up here, please?

All right. Ms. Calimafde, Judy Mazo, Gail Shaffer—nice to see you again, Gail.

Ms. SHAFFER. Nice to see you.

Chairman HOUGHTON. You miss Albany or New York City.

Ms. SHAFFER. I miss the whole State.

Chairman HOUGHTON. The whole State, all right—Ray Pool and Wayne Schneider. So, thank you very much for being so patient. The panel, or what is remaining of it, will be back soon, and I don't see any reason why we can't go right ahead. So, Paula, would you begin?

STATEMENT OF PAULA A. CALIMAFDE, CHAIR, SMALL BUSINESS COUNCIL OF AMERICA, BETHESDA, MARYLAND, ON BEHALF OF SMALL BUSINESS LEGISLATIVE COUNCIL, AND PROFIT SHARING/401(K) COUNCIL

Ms. CALIMAFDE. It is a pleasure to be here tonight. My name is Paula Calimafde; I am the Chair of the Small Business Council of America. This is a national non-profit organization which represents small business exclusively in Federal tax and employee benefit matters. Virtually all of our members have retirement plans.

I am also here on behalf of the Small Business Legislative Council. SBLC is a permanent coalition of trade associations, nearly 100 trade associations. It is made up of such diverse associations as the Truckers, the Florists, and the Home Builders Association.

I am also here on behalf of the Profit-sharing 401(k) Council of America which is also a non-profit association which for the past 50 years has represented companies that sponsor profit-sharing and 401(k) plans. Its members range in size from very small businesses to large business.

I am also a practicing tax attorney; have done so for more than 20 years. I specialize in qualified retirement plans and in estate planning. I was a Presidential Delegate to the White House Conference on Small Business in 1995, and at that Conference, out of 60 final recommendations that emerged, the number 7th recommendation in terms of votes was a pension recommendation. And it is interesting to note that H.R. 1102 actually incorporates most of the recommendations made by the White House Conference delegates to that conference in 1995.

Now, you might ask, why did the small business delegates consider a pension recommendation to be so important that they would have voted it to be number 7 out of 60? The reason was is that small business owners want retirement plans and they want retirement to be a viable option for them. Unfortunately, many small business owners perceive the retirement system as a quagmire of complex rules and burdens. They perceive it as a system that discriminates against them and key employees, and they understood that as the system became more user-friendly and provided sufficient benefits, they would want to use it.

I was also a delegate appointed by Senator Trent Lott to the National Summit on Retirement Savings, and at that Summit I was able to share concerns and hear information from other fellow delegates, and even though the small business sector was not well represented, their ideas came through loud and clear. Their message was increase benefits, decrease costs. Now, we are all aware of the low number of retirement plans sponsored by small businesses. The statistic most often cited is that only 20 percent of small businesses sponsor retirement plans. I think the number is probably a little higher. This number does not include the SIMPLE plan, and from what I have heard this is particularly attractive to companies with fewer than 10 employees. It seems like there is quite a bit of coverage coming in with the SIMPLE plan. But let us be optimistic and say that SIMPLE brought in another 15 percent, we are probably still around 35 percent to 40 percent of small businesses sponsoring retirement plans; that is too low.

We believe there are three reasons why small businesses choose not to adopt a retirement plan, and H.R. 1102 addresses all three of these. First, lack of profitability. H.R. 1102 addresses this problem by adding the salary deduction only simple plan. This plan costs virtually nothing for a small business to sponsor. There are no fiduciary requirements, no reporting requirements, and the plan will allow eligible employees to save for their own retirement up to $5,000 by payroll deduction which is a relatively painless way to save. We have seen with the 401(k) plan, that is the way people save.

The second major reason why small business does not sponsor retirement plans is because the system is perceived a too complex and too costly, and, by the way, it is deservedly so perceived that way by small business. The constant change of the 1980's and early nineties, combined with reduced benefits, brought stagnation to the system and then decline.

There are two reasons why this legislation was going on in the eighties and early nineties: one, was Congress needed revenue, and what better place to look than the pension system which very few people understood and few people were watching, but the second reason was there was some real abuse in the pension system, and some of the bills really solved that abuse; they did good things. Unfortunately, instead of using a flyswatter, Congress ended up using a nuclear bomb that basically detonated the retirement plan system.

It is important to understand that H.R. 1102 preserves the safeguards for the non-highly compensated employees so that they are fully protected, but what it is doing is it is stripping away unnecessary and overlapping rules, so that true simplification is being achieved here but not at the cost of non-highly compensated employees.

H.R. 1102 provides real answers. It removes the burdens of the top-heavy rules; it does not remove the top-heavy rules themselves. The minimum required contribution is still there. The accelerated vesting is still there. What it takes away are rules such as having to maintain five years of records to determine whether the plan is top-heavy or not. It would simplify portability; it would repeal the multiple test for the 401(k) plan; it would eliminate user fees and would give a credit for small business to sponsor plans at reduced costs.

The third reason why small business has stayed away from the system was that small business perceived that the benefits to bederived were too low. Cutbacks in contribution levels hurt key employees and owners, but it also hurt the non-highly compensated, and it took awhile for that correlation to be obvious that if you cut back on the owners, they would cut back on the non-key employees also. H.R. 1102 solves this problem. It would increase the benefits. In reality, it would return the limits back to 1982.

It is interesting, if you look at the defined contribution limit which was $45,475 in 1982, and assume a constant 3 percent COLA, you come up with a $75,163 limit; that is what the limit would be today. Interesting, that would also be the limit on 401(k) plans. It was only in 1987 that the 401(k) plan limit was cut back to $7,000. And the defined benefit plan using that same rationale would be at $225,000, so we are really cutting back to where we were 17 years ago—we are trying to get back there. I think it is important for the small business owner to be able to say, particularly, women who are in and out of the market, and this gives them an opportunity with 401(k) plans to be able to put in more, and there is a very good catch-up provision which would also help them.

In summary, this bill really provides an opportunity to bring increased small business formation of plans and to provide a lot of extra retirement security for millions of Americans. Thank you very much.

[The prepared statement follows:]

Statement of Paula A. Calimafde, Chair, Small Business Council of America, Bethesda, Maryland; on behalf of Small Business Legislative Council; and Profit Sharing/401(K) Council

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

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

The Profit Sharing/401(k) Council of America (PSCA) is a non-profit association that for the past fifty years has represented companies that sponsor profit sharing and 401(k) plans for their employees. It has approximately 1200 company members who employ approximately 3 million plan participants. Its members range in size from a six-employee parts distributor to firms with hundreds of thousands of employees.

I am Paula A. Calimafde, Chair of the Small Business Council of America and a member of the Board of Directors of the Small Business Legislative Council. I am also a practicing tax attorney (over 20 years) who specializes in qualified retirement plans and estate planning. I can also speak on behalf of the Small Business Delegates to the 1995 White House Conference on Small Business at which I served as a Presidential Delegate. At this conference out of 60 final recommendations to emerge, the Pension Simplification and Revitalization Recommendation received the seventh highest ranking in terms of votes. It is important to note that H.R. 1102, the Comprehensive Retirement Security and Pension Reform Act, just introduced on March 11, incorporates almost all of the recommendations made by the delegates to the 1995 White House Conference on Small Business.

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

As a delegate appointed by Senator Trent Lott to the National Summit on Retirement Savings, I was able to share information and concerns with fellow delegates in break out sessions. Even though small business retirement plan experts, administrators and owners were not well represented, their ideas came through loud and clear in the break out sessions. Calls for repeal of the top heavy rules, increases in contribution limits, particularly the 401(k) limit, elimination of costly discrimination testing in the 401(k) area, and a return to the old compensation limits, were repeated across the break out sessions. There were even individuals calling for support of a particular piece of legislation—the Portman-Cardin retirement plan bill (this was last year's bill). Of course, many ideas were discussed particularly in the educational area, but an impartial observer would have noticed that the small business representatives were very united in their message—increase benefits, decrease costs. In other words, when undertaking a cost/benefit analysis, small business currently perceives the costs too high as compared to the benefits to be gained.

At the Summit, the following problems facing small businesses in the retirement plan area were brought up: staff employees' preference for cash or health care coverage, the revenue of the business beings too uncertain, the costs of setting up the plan and administering it being too high, required company contributions (i.e., the top heavy rules) being too high, required vesting giving too much to short term employees, too many governmental regulations, and benefits for owners and key employees being too small. When asked what could break down these barriers, the following answers were given: reduce the cost by giving small businesses tax credits for starting up a plan; repeal the top-heavy rules; reduce administration; allow owners and key employees to have more benefits; and change lack of employee demand by educating employees about the need to save for their retirement now. Some small businesses believed that until they were more profitable nothing would induce them to join the system.

Today we are here to focus on employer coverage and employee participation issues, explore ways to remove burdensome regulatory requirements, improve the level of benefits that workers may accrue towards their retirement and improve the portability of pension benefits. The SBCA, SBLC and PSCA all strongly support the landmark legislation, H..R. 1102. This legislation if enacted will promote the formation of new small business retirement plans, significantly reduce overly complex and unnecessary regulatory requirements, increase portability and overall provide more retirement security for all Americans.

I want to share with you two real life examples. A visiting nurses association in Vermont just established a 401(k) plan. The average salary of the roughly 150 participants is $17,000. 90% of the employees decided to participate in the plan by saving some of their current salary for future retirement security. The *average* amount saved from their salaries and put into the 401(k) plan was 8%. Many were at the 10% to 15% levels. Some of the employees would have gone beyond 15% if they had been allowed to do so. Many of these employees live in very rural areas of Vermont, but they understood the message—it is imperative to save now for your retirement security later. They understood it's primarily their responsibility to provide for their retirement income not the federal government's responsibility.

A criticism sometimes aimed at the retirement plan system is that it is used disproportionately by the so-called "rich" or the "wealthy." Practitioners who work in the trenches know better. The rules governing the qualified retirement system force significant company contributions for all non-highly compensated employees if the highly compensated are to receive benefits. The 401(k) plan, in particular, is a tremendous success story. Employees of all income levels participate, even more so when there is a company match. The real example set forth above is not unusual (though perhaps the level of savings is higher than normal).

Here's another example. This is a local company specializing in testing new drugs, particularly those designed to prevent or slow down AIDS. The company started off about 20 years ago with roughly 20 employees. For each of the last 20 years, this company has made contributions to its profit sharing plan in the amount of 8% to 10%. The company has now grown to about 220 employees. Their long-timers now have very impressive retirement nest eggs. The company believes this money has been well spent. It enjoys the well-deserved reputation of being generous with benefits and employee turn-over is way below the norm for this industry.

This is a retirement plan success story—a win-win situation. The company has a more stable and loyal workforce of skilled employees. The employees in turn will have retirement security. This plan benefits all eligible employees regardless of income level. Every eligible employee in the company has received in effect an 8% to 10% bonus every year which was contributed on their behalf into a qualified retirement trust where it earned tax free growth.

If these real life examples were representative of the small business retirement world, there would be no need for the comprehensive legislation set forth in H.R. 1102. We are all aware, however, of the low number of retirement plans sponsored by small businesses. The statistic most often cited is that only 20% of small businesses sponsor retirement plans. This statistic does not yet include the new SIMPLE plan which seems to be gaining in popularity, particularly with companies with fewer than 10 employees. So let's be optimistic and add another 15% coverage in the small business world—even at 35%, plan coverage is still too low.

There are three major reasons why a small business chooses not to adopt a retirement plan and H.R. 1102 addresses all three.

First, lack of profitability. H.R. 1102 addresses this problem by adding a new salary reduction only SIMPLE plan. This is a plan that a small business will adopt regardless of its lack of profits because it costs the company almost nothing to sponsor. This plan rests on an IRA framework so the company has no reporting requirements or fiduciary responsibilities. Also the company is not required to make any contributions to the plan—so profitability is irrelevant. The plan will give every eligible employee of the company a chance to contribute $5,000 for his or her own retirement security each year.

The second major reason why small business does not sponsor retirement plans is because the system is perceived (and deservedly so) as too complex and costly. The devastating legislation of the 80's and early 90's layered additional requirements on small business, such as the top-heavy rules, with overlapping and unnecessarily complex rules aimed at preventing abuse in the system or discrimination against the non-highly compensated and non-key employees. This constant change combined with reduced benefits first brought the system stagnation and then decline. This legislation was prompted by the need to get short term revenue and where better to look then the pension system that no one understood and few were watching. It was also prompted by a need to rid the system of some real abuse (for instance back about 20 years ago , it was possible for a retirement plan to only make contributions for employees who earned over the Social Security wage base, this rule was eliminated and for good reason). Unfortunately, rather than using a fly swatter, a nuclear bomb was detonated and we ended up with a system in real disrepair. H.R. 1102 preserves the safeguards for non-highly compensated employees so that they are fully protected, while stripping away the unnecessary and overlapping rules so that true simplification is achieved.

H.R. 1102 provides reasoned answers. By stripping away needless complexity and government over regulation in the form of micro management, the system will have a chance to revive. This bill would go a long way towards removing the significant burdens imposed on small business by the top heavy rules. It would simplify portability. It would repeal the absurdly complex and unnecessary multiple use test. It would truly simplify the system without harming any of the underlying safeguards.

Costs would be reduced by eliminating user fees and providing a credit for small business to establish a retirement plan. This credit would go a long way towards reducing the initial costs of establishing a plan.

The third reason why small businesses stay away from the retirement system is that the benefits that can be obtained by the owners and the key employees are perceived as too low. It is no secret that small business owners believe that the retirement plan system discriminates against them. Short vesting periods and quick eligibility have provided more benefits for the transient employees at the expense of the loyal employees. Cutback in contribution levels hurt key employees and owners, (of course they hurt the non-highly compensated also, but it took a long time to understand there was a very real correlation between what the small business owners could put away for themselves and their key employees and what would be put in for the non-highly compensated employees) .

H.R. 1102 solves this problem also. This legislation understands there are two pieces to the puzzle—a reduction in complexity and costs is essential but is not sufficient by itself. A second piece is required. Increasing the contribution limits (in reality reversing the limits) to where they stood in 1982 is equally important.

It is interesting to examine where these limits would be today if the law in 1982 had not been enacted. The defined contribution limit which was $45,475 in 1982, assuming a constant 3% COLA would have been $75,163 in 1999. This is where 401(k) limit would have been also. Only in 1987, was the amount an employee could save by 401(k) contributions on an annual basis limited to $7,000 and the "ADP" tests could further limit the amount (below $7,000) for the highly compensated employees. The defined benefit limit which was at $136,425 in 1982, assuming a constant 3% COLA would be at $225,490 today. These numbers assume a constant COLA of 3%. The true number during those years would be closer to an average of 4%–5%.

Given how critical it is for people to start saving for their own retirement today, it seems most peculiar to have limits harsher than what they were 17 years ago. Some people say that these limits will not operate as an incentive to small businesses to sponsor the plan and will only be used by the so-called "rich." Not only will the increased limits serve as an incentive to small businesses to sponsor a retirement plan, but the higher limits will be enjoyed by employees who are not "rich". For instance, it is very common today for both spouses to be employed. Quite often, these couples decide that one of the spouse's income will be used as much as possible to make contributions to a 401(k) plan. Today, the most the couple can save is $10,000 (and if the participant spouse makes more than $80,000 or makes less but is a 5% owner of a small business, then the couple might not even be able to put in $10,000). Often, the couple would have been willing to save more. These couples might make $40,000, $50,000 or more, but they are not "rich." It is only because both spouses are working, that they are making decent income levels—we should provide the means by which they can save in a tax advantaged fashion while they can.

This same principle applies particularly to women who enter and leave the work force intermittently as the second family wage earner. They and their families stand to benefit the most from increased retirement plan limits because they will provide the flexibility that families require as their earnings vary over time and demands such as child rearing, housing costs and education affect their ability to save for retirement.

Many mid-size employers rely less on their existing defined benefit plan to provide benefits for their key employees and more on non-qualified deferred compensation plans. This is a direct result of the reduction in the defined benefit plan limit. In 1974, the maximum defined benefit pension at age 65 was $75,000 a year. Today the maximum benefit is $130,000, even though average wages have more than quadrupled since 1974. Thus, pensions replace much less pre-retirement income now than they did in the past. In order for these ratios to return to prior levels, the maximum would have to be over $300,000 now. The lower limits have caused a dramatic increase in non-qualified pension plans, which provide benefits over the limits. They help only the top-paid employees. This has caused a lack of interest in the defined benefit plan since there is no incentive to increase benefits since the increases cannot benefit the highly compensated employees or key employees. This is unfortunate since increases affect all participants.

Recently, there has been talk of the retirement plan tax expenditure in 1999 being approximately 100 billion dollars with 20% going to the top 1% of taxpayers, 75% going to the top 20% of taxpayers with less than 10% going to the bottom 60% of taxpayers. (This is based on a one page memo distributed by the Office of Tax Analysis at the Department of Treasury entitled Distribution of Pensions Benefits Under Current Law-Talking Points.) According to EBRI, the total pension tax expenditure in the FY 1993 federal budget was $56.5 billion. Of this amount $27.9 billion (or 49.4%) was attributable to public-sector defined benefit pension plans. Private sector defined contribution plans followed at $19.3 billion (34.2%), followed by private-sector defined benefit plans at $8.2 billion (14.5%) and public sector defined contribution plans at $1.1 billion (2%). Thus, the true number we were dealing with in 1993 in connection with the private retirement system is $27.5 billion. Even assuming arguendo that the expenditure has grown from 1993 to 1999by 43.5 billion dollars, the expenditure for the private retirement system would be roughly 48.7 billion dollars which is a far cry from 100 billion. The landmark Portman-Cardin legislation deals only with the private retirement system.

EBRI found that in 1992, the value of the pension tax expenditure was allocated as follows:

Income Class	Percent
Less than $10,000	0.0
10,000–19,999	1.4
20,000–29,999	7.1
30,000–49,999	28.1
50,000–99,999	42.8
100,000–199,999	13.4
200,000 and over	6.7

See EBRI Issue Brief February, 1993. Again, these numbers do not appear to square with the numbers distributed by the Office of Tax Analysis of the Department of Treasury. The EBRI numbers are based on actual data. It would appear with the proliferation of 401(k) plans and how much they are used by the non-highly compensated employees that the numbers today would be increased in the $20,000 and $30,000 groupings and further decreased in the top two income levels due to the continued growth in the non-qualified plan area.

The importance of bringing these limits back to the 1982 levels cannot be underestimated. They are crucial if small business is to be persuaded to join the system.

Another major "fix up" in this bill deals with Section 404. This section limits a company's deductible contribution to a profit sharing plan to 15% of all participant's compensation. This limit presently includes employee 401(k) contributions. This means that if an employer chose to make a 15% contribution to a profit sharing plan, then no employee would be allowed to make a 401(k) contribution. Realizing the absurdity of this rule, H.R. 1102 would no longer count employee contributions (401(k)) towards the 15% overall deduction level.

Even more importantly, the 15% level would be raised to 25%.

This bill is indeed comprehensive legislation which will inject needed reforms into the pension system and by doing so will truly provide retirement security for countless Americans. It will increase small business coverage and it is important that we all work hard to see this entire bill enacted into law.

The Department of Labor's ERISA Advisory Council on Employee Welfare and Benefit Plans recently released its Report of the Working Group on Small Business: How to Enhance and Encourage The Establishment of Pension Plans dated November 13, 1998. This report provides eight recommendations for solving the problems facing small businesses today in the retirement plan area. Interestingly, these recommendations mirror many of those that came out of the National Summit on Retirement Savings.

The Advisory Council report calls for a Repeal of Top-Heavy Rules, Elimination of IRS User Fees, an Increase in the Limits on Benefits and Contributions, an Increase in the Limits on Includable Compensation, the Development of a National Retirement Policy, Consider the development of Coalitions, Tax Incentives and the Development of a Simplified Defined Benefit Plan.

The Report explains the legislative development of the top-heavy rules and then summarizes the layers of legislation that occured subsequent to their passage which made them obsolete. The Report states, "The top-heavy rules under Internal Revenue Code Section 416 should be repealed....Their effect is largely duplicated by other rules enacted subsequently....They also create a perception within the small business community that pension laws target small businesses for potential abuses. This too discourages small business from establishing qualified retirement plans for their employees."

It is important to note that the Portman-Cardin legislation dramatically improves the top-heavy rules and significantly reduces administration expenses associated with them.

The Report calls for the elimination of User Fees imposed by IRS. The Report in part states, "The imposition of user fees adds another financial obstacle to the adoption of qualified retirement plans by small business. Although user fees apply to all employers—large and small—the cost of establishing a plan is more acutely felt among small employers. User fees do not vary by size of employer....Now that the budget deficit has become a budget surplus, the economic justification for user fees is much diminished. User fees should be repealed."

H.R. 1102 addresses the user fee issue to assist small businesses in sponsoring retirement plans.

The Advisory Council Report calls for increasing the limits on benefits and contributions:

> The defined benefit and defined contribution plan dollar limit were indexed by ERISA and were originally established in 1974 at $75,000 and $25,000 respectively. From 1976 to 1982, the indexing feature was allowed to operate as intended and the dollar amounts grew to $136,425 and $45,475. Under the Tax Equity and Fiscal Responsibility Act of 1982, the dollar limit on defined benefit plans was reduced to $90,000 and the dollar limit on defined contribution plans was reduced to $30,000. ...
>
> These reductions in the dollar amounts are widely believed to have been revenue driven. These reductions had the net effect of adjusting downward the maximum amount of benefits and contributions that highly-paid employees can receive in relationship to the contributions and benefits of rank and file employees. ...
>
> In order to give key employees the incentive needed to establish qualified retirement plans and expand coverage, we recommend that the $30,000 dollar limit on defined contribution plans be increased to $50,000 which will help partially restore the dollar amount to the level it would have grown to had the indexing continued without alteration since the dollar limit was first established in 1974.
>
> Second, we recommend that the $90,000 dollar limit on defined benefit plans be increased to $200,000 which will restore the dollar amounts lost through alterations in the dollar amount since 1974, while maintaining the 1:4 ratio established in 1982 as part of TEFRA.
>
> Third, we recommend, that in the future, indexing occur in $1,000, not $5,000 increments which has had the effect of retarding recognition of the effect of inflation.

And finally the report concludes,

> We recommend, that actuarial reductions of the defined benefit plans dollar limit should be required only for benefits commencing prior to age 62. This was the rule originally enacted in 1974 as part of ERISA.

The Portman-Cardin legislation increases the contribution limits with respect to all of the retirement plans. As discussed in more detail below, this is perhaps one of the most important changes that can be made to the system to increase small business access.

The Report also calls for a corresponding increase in the limit on includable compensation for similar reasons. "Under ERISA, there was no dollar limit on the amount of annual compensation taken into account for purposes of determining plan benefits and contributions. However, as part of the Tax Reform Act of 1986, a qualified retirement plan was required to limit the annual compensation taken into account to $200,000 indexed. The $200,000 limit was adjusted upward through indexing to $235,843 for 1993. As part of the Omnibus Budget Reconciliation Act of 1993, the limit on includable compensation was further reduced down to $150,000 for years after 1994. Although indexed, adjustments are now made in increments of $10,000, adjusted downward. In 1998, the indexed amount is $160,000." "We recommend that the limit on includable compensation be restored to its 1988 level of $235,000 be indexed in $1,000 increments in the future."

The Portman-Cardin legislation will return the compensation limit back to where it stood in 1988. The system is perceived by many small business owners as discriminatory against key employees; this type of change will allow it to be perceived as more fair to all employees.

The Report develops a number of recommendations in the area of education, including using public service spots on television, radio and in the printed media to educate the public and raise the awareness of the need to prepare and save for retirement. Virtually all of the Report's recommendations in this area also were made at the National Summit on Retirement Savings. This is a critical area for small business. Clearly, more small businesses will want to sponsor retirement plans if retirement benefits are perceived as a valuable benefit by their employees.

One of the direct benefits to come out of the National Retirement Summit is the educational spots being put on the air by ASEC and EBRI. It is critical for the public to become educated about the need to start saving for their retirement and the benefits of starting early.

The Report also discussed the possibility of developing coalitions to offer pooling vehicles for small employers. Absent a great deal of persuasive testimony, it would seem that the idea of multiemployer plans should not be extended to small businesses without a collective bargaining agreement. While certainly no expert in the area, the multiemployer plans are not well liked by small business and often provide horrendous problems when a termination occurs. Further, it is quite simple for a small business to adopt a prototype 401(k) or SIMPLE plan sponsored by a financial institution or an insurance company. It's hard to see how a coalition could make this process simpler, but we would be willing to see where this idea could lead.

The Report calls for tax credits that could be used as an incentive for a small business to adopt a qualified retirement plan or to offset administration costs or even retirement education costs.

H.R. 1102 provides tax credits as an incentive for small businesses to adopt retirement plans.

Finally the Advisory Council calls for a Simplified Defined Benefit Plan.

The graying of America, and the burden that it will place on future generations, should not be ignored. The American Council of Life Insurance reports that from 1990 to 2025, the percentage of Americans over 65 years of age will increase by 49%. This jump in our elderly population signals potentially critical problems for Social Security, Medicare and our nation's programs designed to serve the aged.

While we must shore up Social Security and Medicare, it is clear that the private retirement system and private sources for retiree health care will have to play a more significant role for tomorrow's retirees. The savings that will accumulate for meeting this need will contribute to the pool of capital for investments that will provide the economic growth needed to finance the growing burdens of Social Security and Medicare. The policy direction reflected by H.R. 1102 will ensure that sufficient savings will flow into the retirement plan system so as to provide a secure retirement for as many Americans as possible.

The last two bills passed by this Congress, (both Portman-Cardin bills)dealing with the retirement plan system, began the process of simplifying the technical compliance burdens so that small businesses are able to sponsor qualified retirement plans. H.R. 1102 represents another huge step forward. Indeed, if this legislation becomes the law, only a few and relatively minor changes remain to fully restore the system to its former health prior to the onslaught of negative and complex changes of the 1980's while retaining the needed reforms introduced during that period.

SBCA, SBLC and PSCA strongly support the following items in H.R. 1102 which will greatly assist businesses, and particularly small businesses, in sponsoring retirement plans:

401(K) CHANGES

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

The forced savings feature of the 401(k) plan cannot be underestimated and must be safeguarded. When a person participates in a 401(k) plan, he or she cannot remove the money on a whim. Savings can be removed by written plan loan which cannot exceed 50% of the account balance or $50,000 whichever is less. Savings can be removed by a hardship distribution, but this is a tough standard to meet. The distribution must be used to assist with a statutorily defined hardship such as keeping a house or dealing with a medical emergency. This is in contrast to funds inside an IRA or a SIMPLE (which is an employer sponsored IRA program) where the funds can be accessed at any time for any reason. True, funds removed will be subject to a 10% penalty (which is also the case for a hardship distribution from a 401(k) plan), but preliminary and totally unofficial data suggests that individuals freely access IRAs and SEPs (also an employer sponsored IRA program) and that the 10% penalty does not seem to represent a significant barrier. In fact, this is why the SIMPLE IRA starts off with a 25% penalty for the first two years an individual participates in SIMPLE in hopes that if a participant can accumulate a little bit he or she will be tempted to leave it alone and watch it grow. Nevertheless, there is a distinct difference between asking the employer for a loan or a hardship distribution and having to jump through some statutorily and well placed hoops versus simply removing money at whim from your own IRA.

- Increasing 401(k) contributions from $10,000 to $15,000 is a significant, beneficial change which will assist many employees, particularly those who are getting closer to retirement age.
- Opening up the second 401(k) Safe Harbor, the "Match Safe Harbor" to small businesses by exempting it from the Top-Heavy Rules is a valuable change which places small businesses on a level playing field with larger entities.
- We believe that the voluntary safe harbors will prove to be the easiest and most cost effective way to make the 401(k) plan user friendly for small businesses. If a small business makes a 3% contribution for all non-highly compensated employees, or makes the required matching contributions, then the company no longer has to pay for the complex 401(k) anti discrimination testing (nor does it have to keep the records necessary in order to do the testing). We recognize that many companies will choose to stay outside the safe harbor because the 3% employer contribution or required match "cost of admission" is too high and because it is more cost-effective to stay with their current system (including software and written communication material to employees). We believe that small business will embrace the voluntary safe harbors that do away with costly complex testing. Legislation which allows small businesses to use either safe harbor could very well prove to be enough of an incentive for companies to begin sponsoring a 401(k) retirement plan.
- Unfortunately, IRS is imposing a Notice Requirement which is very restrictive and will probably cause most small businesses not to be able to use the safe harbor this year. IRS in Notice 98–52 which was published November 16, 1998 requires that a business adopting either safe harbor give notice (in the case of a calendar year plan) by March 1st. Now let's examine the rationale behind the notice requirement and see whether this type of restriction is justified. Remember there are two safe harbors—one is a prescribed company match to employee 401(k) contributions, the other is a non-elective 3% contribution. A non-elective 3% contribution means that every eligible employee receives this contribution whether or not he or she makes 401(k) contributions. The rationale for notice in the context of the match safe harbor is self evident. An employee may very well change his or her behavior and contribute more 401(k) contributions knowing that a match is going to be made. There appears to be no rationale for notice in the context of the non-elective 3% contribution—no employee is going to change any behavior on knowing that a contribution will be made for them at the end of the year. The problem of course is compounded when dealing in the small business world. Unless an outside advisor has informed a small business that it must give a fairly extensive notice by March 1st and the company complies, it will not be able to take advantage of the safe harbor for this entire year. My guess is that there will be many, many small businesses this year who would have taken advantage of the 3% non-elective safe harbor but will not be able to do so because they had not been informed of the requirements of this overly restrictive notice requirement. Thus, they will not be able to rid themselves of the complex and costly 401(k) anti-discrimination testing this year.

IRS also has stated that the 3% non-elective contribution must be paid to every non-highly compensated employee regardless of whether they have completed 1000 hours and whether he or she is employed on the last day of the plan year. This is more restrictive than either the rule for normal plan contributions or the rule for the top-heavy minimum contributions. There seems to be no rationale for a safe harbor which is designed to help small business avoid complicated testing to be made so restrictive.

SBCA, SBLC and PSCA suggest that the notice requirement be changed to within 30 days of the close of the plan year for those companies selecting the 3% non-elective contribution safe harbor. This change will allow word to get out to small business about this option and give them time to comply with the notice requirement. We also suggest that the 3% non-elective contribution be made to either all non-highly compensated employees who have worked 1,000 hours or to those employees who are employed on the last day of the plan year, but not both.

- Increasing the IRC Section 404 15% deduction limit to 25% is a major change which will appreciably assist small businesses. Section 404 limits a company's deduction for profit sharing contributions to 15% of eligible participants' compensation. Because of this rule, today many companies, including small businesses, sponsor two plans because the 15% limit is too low for the contributions they are putting in for their employees. Most often a money purchase pension plan is coupled with a profit sharing plan to allow the company to get up to a 25% deduction level. By requiring companies to sponsor two plans where one would do, administration expenses and user fees are doubled. Each year the company is required to file two IRS 5500 forms instead of one. The company is required to have two summary plan descriptions instead of one. This change would truly simplify and reduce administration expenses and exemplifies the outside of the box thinking found in H.R. 1102.

- The Qualified Plus Contribution is an exciting concept which may prove to be sought after by employees contributing 401(k) contributions.
- Excluding 401(k) contributions made by the employees from the IRC Section 404 15% deduction limit will make these plans better for all employees. Today, employee 401(k) contributions are included in the Section 404 limit. Section 404 limits a company's deduction for profit sharing contributions to 15% of eligible participants' compensation. This limit covers both employer and employee 401(k) contributions. This limitation now operates against public policy; either employer contributions are cut back which works to the detriment of the employees' retirement security *or* employee pre-tax salary deferred contributions must be returned to the employee. Thus, employees lose an opportunity to save for their retirement in a tax-free environment. This is particularly inappropriate since the employee has taken the initiative to save for his or her retirement, exactly the behavior Congress wants to encourage, not discourage.
- Repeal of the complicated "Multiple Use Test" is a very welcome change and will benefit the entire retirement plan system. This test was nearly incomprehensible and forced small businesses (really their accountants or plan administrators) to apply different anti-discrimination tests to employer matching contributions than what may have been used for the regular 401(k) anti-discrimination tests.
- Allowing employee-pay all 401(k) plans for small business is fair. Portman-Cardin would allow a key employee to make a contribution to a 401(k) plan sponsored by a small business without triggering the top-heavy rules were triggered so that the small business was required to make a 3% contribution for all non-key employees. Not only is this a trap for the unwary since many small businesses, including their advisors, are unaware of this strange rule, but it is also unfair since a larger company would be able to sponsor an employee-pay-all 401(k) plan and not have to make any employer contributions to the plan. The regular 401(k) anti-discrimination tests are more than sufficient to ensure that the non-highly compensated employees are treated fairly vis a vis the highly compensated employees.
- The so-called "Catch-Up Contributions" for people approaching retirement will be very helpful for small business employees, particularly those who were not able to save while they were younger.

Changes to Plan Contribution Limits

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

- Increasing the $150,000 compensation limit to $235,000 is an important change which will bring the plan contributions back into line with 1998 dollars. The $150,000 limit in 1974 (ERISA) dollars is about $46,500 (assuming 5 percent average inflation). This is far below the $75,000 that represented the highest amount upon which a pension could be paid under then-new Code Section 415 (back in 1974). This cutback has hurt several groups of employees-owners and other key employees of all size businesses who make more than $150,000 and mid-range employees and managers (people in the $50,000 to $70,000 range) who are in 401(k) plans and in defined benefit plans. This cutback was perceived by owners and other key employees of small businesses as reverse discrimination and as a disincentive in establishing a retirement plan.
- Increasing the defined contribution limit from $30,000 to $45,000 and the defined benefit limit from $130,000 to $180,000 are strong changes which will increase retirement security for many Americans. These numbers are in line with actual inflation.

Top Heavy Rules

These rules are now largely duplicative of many other qualification requirements which have become law subsequent to the passage of the top-heavy rules. They often operate as a "trap for the unwary" particularly for mid-size businesses which never check for top-heavy status and for micro small businesses which often do not have sophisticated pension advisors to help them. These rules have always been an unfair burden singling out only small to mid-size businesses. The changes made in H.R. 1102 will significantly simplify the retirement system with little to no detriment to any policy adopted by Congress during the last decade. The top-heavy rules have required extensive record keeping by small businesses on an ongoing 5 year basis. They also have represented a significant hassle factor for small business—constant interpretative questions are raised on a number of top-heavy issues and additional work is required to be done by a pension administrator when dealing with a top-heavy plan, particularly a top-heavy 401(k) plan.

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

We also support the simplified definition of a key employee as well as only requiring the company to keep data for running top heavy tests for the current year rather than having to keep it for the past four years in addition to the current year.

SIMPLE Plans

It is exciting to see that the SIMPLE is attracting so many small businesses. We believe, though, that the SIMPLE plan should be viewed as a starter plan and that all businesses, including the very small, should be given incentives to enter the qualified retirement plan system as quickly as possible. The SIMPLE is an IRA program, as is the old SEP plan and in the long run true retirement security for employees is better served by strengthening qualified retirement plans rather than SIMPLES and SEPs. This is simply because employees have a far greater opportunity to remove the money from IRAs and SEPs and spend it—the forced savings feature of a qualified retirement plan is not present. While we appreciate that for start-up companies or micro businesses, a SIMPLE or the proposed salary reduction SIMPLE is the best first step into the retirement plan system, the company should be encouraged to enter the qualified retirement system as soon as possible. By making the SIMPLE rules "better" than the qualified retirement system, the reverse is achieved. Thus, we hope that the "gap" between the 401(k) limit ($15,000) and the SIMPLE limit ($10,000) and the salary reduction SIMPLE limit ($5,000) is carefully preserved so that the system does not tilt in the wrong direction.

We do not believe that any other new plans than those set forth in H.R. 1102 are needed. We now have a very good mix of plans—from those which provide flexibility and choice to very simple plans for the companies who do not want administration costs.

Required Minimum Distribution Rules

We support exempting a minimum amount from the required minimum distribution rules. We would encourage the Committee to also consider whether the rule which delays receiving distributions for all employees, other than 5% owners, until actual retirement, if later, should be extended to 5% owners. There seems to be no policy rationale for forcing 5% owners to receive retirement distributions while they are still working.

We also respectfully suggest the following:

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

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

3. Section 404(a)(7) should be eliminated. Section 404(a)(7) is an additional deduction limitation imposed on companies that sponsor any combination of a defined benefit plan and a defined contribution plan. When a company chooses to sponsor both types of plans, then it is limited to a 25% of compensation limit. The defined

benefit plan is subject to a myriad of limitations on deductions and contributions. The defined contribution plan is likewise subject to its own limitations on deductions and contributions. This extra limitation often hurts the older employees who would otherwise receive a higher contribution in the defined benefit plans. Often companies simply choose not to sponsor both types of plan because of this limitation.

PLAN LOANS FOR SUB-S OWNERS, PARTNERS AND SOLE PROPRIETORS

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

REPEAL OF 150% OF CURRENT LIABILITY FUNDING LIMIT

This is a very technical issue, but basically defined benefit plans are not allowed to fund in a level fashion. Code Section 412(c)(7) was amended to prohibit funding of a defined benefit plan above 150 percent of current "termination liability." This is misleading because termination liability is often less that the actual liability required to close out a plan at termination, and the limit is applied to ongoing plans which are not terminating. This provision is particularly detrimental to small businesses who simply cannot adopt a plan which does not allow funding to be made in a level fashion. The changes made to this law by H.R. 1102 are critical for small businesses to be able to sponsor defined benefit plans.

We also applaud the change in the variable rate premium which will assist small businesses which are not allowed to fund in a proper fashion because of this limitation.

A small business will go through a cost-benefit analysis to determine whether to sponsor a qualified retirement plan. A number of factors are analyzed including the profitability and stability of the business, the cost of sponsoring the plan both administratively as well as required company contributions, whether the benefit will be appreciated by staff and by key employees and whether the benefits to the key employees and owners are significant enough to offset the additional costs and burdens. The legislation being contemplated by this Committee will dramatically improve the qualified retirement plan system. By making the system more user friendly and increasing benefits, more small businesses will sponsor retirement plans. Easing administrative burdens will reduce the costs of maintaining retirement plans. The changes would revitalize the retirement plan system for small business as it is perceived by small businesses as more fair to them. Finally, the positive changes made by Congress in the 1980's would be retained and the time tested ERISA system would stay in place. Ultimately, it is essential for this country to do everything possible to encourage retirement plan savings so that individuals are not dependent upon the government for their retirement well-being.

Chairman HOUGHTON. Well, thank you very much, Ms. Calimafde.

Now, Mrs. Mazo.

STATEMENT OF JUDITH F. MAZO, PROFESSIONAL STAFF, NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS, ON BEHALF OF BUILDING AND CONSTRUCTION TRADES DEPARTMENT, AFL–CIO

Ms. MAZO. Thank you, Mr. Chairman. I am Judy Mazo; I am here today on behalf of the Building and Construction Trades Department of the AFL-CIO and the National Coordinating Committee for Multiemployer Plans, which is the only advocacy group for multiemployer, jointly managed, labor management Taft-Hartley plans today.

The issues that I am here to mention today face not only building trades' plans but labor management plans covering collectively bargained workers in a large number of industries that are characterized by multiemployer plans.

I am not going to follow my testimony, and I am going to relieve all of us of the burden of sitting through a little bit more discussion, because I think we got unanimity on relief for multiemployer plans, and the advice is, take yes for an answer and go home. So, I will thank all of you for that.

I do want to just point out that the Portman-Cardin bill and the bill that I think Representative Weller plans to be introducing later this week will provide slighter more complete relief on the 415 limits than the Administration's proposal, and, therefore, we strongly support the bill that gives us more complete relief. And I just want to make one other point. In 1982, as Ms. Calimafde points out, when the 415 limits were dramatically rolled back, there were people who came to President Georgine, Bob Georgine, who is the head of the multiemployer group that I am talking about in the Building Trades Department and said, "Would you all please help us resist this, because it is going to hurt your members?" And we said, "It is not going to hurt our members; you are talking about benefits at $130,000 a year—this was 1982—and our plans don't pay benefits like that. This is not our problem."

Well, we were short-sighted, and we are here today to admit our mistake. You have been hearing from our members; it is hurting us today. The concern about what happens in the future with numbers that sound mighty high today is one that we are living proof to say it happens, and so I thank you, Mr. Chairman, Mr. Portman, for sponsoring H.R. 1102, and you have our support and our assistance. I will look forward to answering any questions.

[The prepared statement follows:]

Statement of Judith F. Mazo, Professional Staff, National Coordinating Committee for Multiemployer Plans, on behalf of Building and Construction Trades Department, AFL–CIO

My name is Judith F. Mazo and I am appearing today on behalf of the Building and Construction Trades Department, AFL-CIO ("the BCTD") and the National Coordinating Committee for Multiemployer Plans ("the NCCMP").

The NCCMP is the only national organization devoted exclusively to protecting the interests of the approximately ten million workers, retirees, and their families who rely on multiemployer plans for retirement, health and other benefits. Our purpose is to assure an environment in which multiemployer plans can continue their vital role in providing benefits to working men and women. The NCCMP is a nonprofit organization, with member plans and plan sponsors in every major segment of the multiemployer plan universe.

The NCCMP endorses and heartily supports the Comprehensive Retirement Security and Pension Reform Act (H.R. 1102) (the "Bill"). Legislation to promote retirement income security, especially through defined benefit pension plans, is long overdue. Enactment of the Bill would be a major step toward simplifying many of the complex pension rules in the Internal Revenue Code that have had the effect of discouraging retirement savings.

While there are many provisions in the Bill that would affect multiemployer plans, my comments today focus only on provisions to amend certain rules under Code section 415 that are forcing reductions in the benefits of workers covered by multiemployer pension plans. The NCCMP will submit a comprehensive written comment on the Bill separately.

Multiemployer Pension Plan Exemption from Code Section 415, 100-Percent of Compensation Limit.

Section 512(a) of the Bill would exempt workers covered by multiemployer pension plans from the Code section 415(b) compensation-based limit, from which government employees are already exempt.

The Code section 415 limits are designed to prevent high-paid individuals from using pension plans as tax avoidance schemes to shelter excessive pension benefits. This does not happen in the context of multiemployer plans.

However, due to the distinctive benefit structure in most multiemployer plans, the work patterns of their participants and the manner in which the contribution streams that fund them are negotiated, a participant's pension benefit may exceed the100-percent of compensation limit. Where this happens, the participants who are hurt by the limit are the lowest paid rank and file workers covered under the plan—the exact opposite of the type of participants these rules were designed to impact.

Multiemployer plans typically provide the same annual retirement benefit to all participants who have the same amount of service, regardless of what they are paid. It is quite rare for a multiemployer plan benefit formula to be based on compensation. Multiemployer plan benefit formulas are therefore very advantageous to lower paid workers. As a percentage of compensation, the more money a participant makes the smaller is his benefit. The effect of these formulas is to provide an adequate retirement benefit even to the lowest paid of these workers, by, in effect, subsidizing those benefits by providing relatively lower benefits to the higher paid workers, even though they may generate a greater volume of employer contributions.

Ironically, it is this very antidiscriminatory aspect of multiemployer plans that creates much of their problem under the 100-percent of compensation limit. The level of plan benefits is set by the trustees with one eye towards what the contribution stream funding the plan can support and the other eye towards the reasonable retirement needs and expectations of the average plan participant. This benefit may, however, be higher than the wages of plan participants who were paid significantly less than the norm, such as, for example, office secretaries in a plan that covers skilled tradespeople.

Another problem is created by the work patterns of many multiemployer plan participants. In a typical single employer plan, a plan participant is employed continuously with the employer that sponsors the plan, throughout his period of participation in the plan. Over time, due to inflation, that participant's compensation will increase. Because this employment is continuous, the three consecutive years in which compensation is the highest—that is, the three years on the basis of which the 100 percent of compensation limit is computed—will typically be the last three years. Thus, in effect, single employer plan participants get the benefit of cost of living adjustments to their 100-percent limit while they are working, because they get the full advantage of their compensation increases due to their continuous employment. Once they leave service, their 100-percent limit is also directly adjusted annually under section 415(d) to reflect increases in the cost of living.

In the context of multiemployer plans, the 100-percent of compensation limit sometimes shrinks, despite cost of living increases in pay rates. As multiemployer plan participants grow older, they may find it more difficult to secure continuous employment, or to work the same high number of hours. The gaps between their periods of employment may become more frequent and more prolonged. This is especially true in industries characterized by hard, physical work, especially outdoors, or work in extreme climates. Even though the negotiated hourly pay rate may have gone up, a reduced number of hours worked during some portion of any period of three consecutive years may prevent that period from being used as the base for computing the 100-percent limit. If an earlier group of three years is used, the worker is deprived of the automatic inflation adjustment to this limit that the typical single employer plan participant would obtain through a salary increase. In addition, because the participant has not yet retired, no direct inflation adjustment to the limit is allowed. This shrinking of the limit is particularly pronounced in declining industries where work has become more scarce in general.

Plan trustees recognize that multiemployer pension benefits are, in effect, paid for by the plan participants, since plan contributions are negotiated as alternatives to higher wages. In some declining industries, to prevent participants from losing their benefits due to inability to find continuous employment, trustees have reduced the number of hours per year necessary to earn a pension credit. For some participants this can increase the severity of the impact of the 100-percent of compensation limit, as their actual pay may decline—even if hourly wage rates go up—because they are working fewer hours. Although it looks as though they are earning additional pension benefits, these participants hit the 100-percent limit and lose their pension benefits anyway.

It is important to note that it is not possible to adjust plan contributions to deal with this problem. Multiemployer plan contribution rates are set through collective bargaining. The rate set for any particular collective bargaining unit is uniform, typically because the hourly wage package is uniform. There is no practical way to provide different contribution rates for different workers depending on the number of hours they work or to vary wages and pension accruals based on the way each person is affected by the section 415 limits, even if it were possible to know or to predict the number of hours a particular worker would work during a particular year or when the section 415 limits would hit. Contributions can only be reduced across the board, and if they are, wages or other benefit plan contributions would need to be increased across the board to maintain the equilibrium and follow through on the bargained-for compensation. So the majority would be denied an adequate pension to avoid having the pension of the lowest-paid among them exceed the 415 limits.

Ironically, the 100-percent of compensation limit is not generally a problem for highly-paid employees. Employers maintaining single employer plans typically provide benefits in excess of the Code section 415 limits for executives through unfunded excess benefit plans. This is not a workable solution for many multiemployer plans. As the Taft-Hartley Act requires multiemployer plan benefits to be provided through a trust, potentially catastrophic tax consequences pose a serious challenge to the creation of a funded plan that does not comply with section 415.

To understand the harshness of the impact of the 100-percent limit on plan participants, it is important to note that, from the worker's perspective, this limit is imposed retroactively. Plan participants ordinarily compute their benefits using the formulas they find in the summary plan descriptions and with reference to their years of service. They make plans for retirement based on the benefits so computed. They usually do not realize the amount of reduction in their benefit that will be made due to the 100-percent limit until they actually retire and make a claim for benefits.

Exemption from Code Section 415 Reductions in Pension Benefits on Early Retirement

Section 101(a)(4) of the Bill would provide for multiemployer plans the same early retirement treatment as is provided under current law to plans maintained by governments and tax exempt organizations.

Many multiemployer plans provide pensions that can be taken on an unreduced basis after a certain number of years of service, e.g. 30. These are referred to, for example, as "30 and out pensions" or "service pensions." In industries that involve hard, physical labor, it is often not feasible for participants to work past their early or mid–50s. For someone who has been working at these backbreaking jobs since high school, "early" retirement represents a well-earned chance to stop working so hard. These special service pensions are reasonably designed to address the income needs of such workers. Yet, the section 415 dollar limit could restrict such workers to receiving little more than $40,000 or so a year.

To prevent this dollar limitation from becoming so low that it interferes with the ability of multiemployer plans, like plans maintained by governments and tax exempt organizations, to provide adequate retirement benefits to early retirees, the Bill would raise the floor applicable to early retirement benefits under those plans from $75,000 to $130,000 at age 55. The Bill also increases the section 415 dollar limit for all plans from $130,000 at Social Security retirement age to $180,000 at age 62, and allows plans to actuarially increase benefits commencing after age 65.

Administrative Relief in Applying the 415 Limits

Section 512(e) of the Bill would make the section 415 tests much simpler for multiemployer plans to administer, an important step to conserve plan assets (which are the only source of funding for operating multiemployer plans, as well as paying their benefits). Under existing Treasury regulations, multiemployer plans do not have to be combined or aggregated with other multiemployer plans when applying section 415. Given the large number of contributing employers for which a participant may have worked under other plans throughout the country, this recognizes the difficulties and expense multiemployer plan sponsors would encounter if they had to search them all out in order to be satisfied that their benefits meet section 415. As a further reduction in red tape, the Bill codifies this rule and extends it to single employer plans. One result of enactment of this change will be to make it easier for multiemployer pension plans to avoid 415 testing for very small benefits—those under $10,000 a year—since it would no longer matter under the 415 de minimis rule whether the participant had ever been covered by any 401(k) plan (or other defined contribution plan) sponsored by a contributing employer.

We appreciate this opportunity to provide testimony on H.R. 1102 and the need for relief for multiemployer plan participants from the Code section 415 rules. We would be pleased to provide additional information at the Committee's request.

Chairman HOUGHTON. Well, thanks, Ms. Mazo, very much.
Ms. Shaffer.

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

Ms. SHAFFER. Thank you, Mr. Chairman. Thank you and all the subcommittee for having these hearings on a very important issue, and thank you for your patience today. I am Gail Shaffer, chief executive officer of Business and Professional Women/USA, a bipartisan, non-for-profit organization representing 70,000 working women across America. A third of our members are business owners, and we are involved in more than 2,000 local organizations in nearly every congressional district in the country. We are also a member of the National Women's Business Council, appointed to advise the President and the Congress on regulations and policies affecting opportunities for women entrepreneurs.

The Business and Professional Women/USA perspective on the Comprehensive Retirement Security and Pension Reform Act is that it will benefit women owned businesses which are the fastest growing segment of our economy, truly a phenomenal engine of our economy in the growth figures on women-owned businesses. The positive features of this legislation are that it grants relief from PBGC premiums for new small business start-ups with defined benefit plans; it eliminates the user fees for those small business plans; it increases portability, which we think is very important for women; improves rollover provisions; cuts administrative burdens, and also now includes provisions to cover the start-up administrative costs with tax incentives as well.

Today, women entrepreneurs employ more people in total than the Fortune 500. In fact, one out of four American workers is currently employed by a women-owned business. The tax expenditures for these small businesses are too high. This bill does not include an education provision to ensure that small businesses understand, however, the full range of their pension options that are available to them. Very often, the only resources they have to explain that are salespersons from financial service companies trying to sell their services, and they need some objective source of information.

Furthermore, the catch-up that was mentioned that allows up to a $15,000 contribution into a 401(k) will benefit women, but only those women at the very high end of the wage scale. When you consider that only 3 percent of full-time working women earn over $75,000, the full benefits of that provision will be limited. So, we would urge that more needs to be done for the average woman who earns significantly less.

In addition, although the New "SIMPLE" provisions are a positive step toward the goal of expanding pension coverage, it could have a regressive effect by discouraging employers from eventually offering employer matching plans. This is in part because the New "SIMPLES" do not include requirements to ensure significant employer participation across the wage scale in a given company, and that could remove incentives for employers to negotiate with their employees on these issues.

The goal here today is to discuss meaningful pension reform that expands coverage, cuts the costs, and improves the retirement security for all of us. Our concern, from BPW's perspective, is the way in which the pension system's current inadequacies disproportionately affect women. BPW has a longstanding interest in this issue, and we are not only working to effect change here on Capitol Hill but also nationwide to educate our own members on the importance of retirement planning. We are very pleased to be working, in fact, in partnership with Ms. Heinz' organization, WISER, to educate our members and other women across the country.

I would like to bring to the committee's attention the disturbing fact that one of the things we are leading in as a country is that the United States has the highest percentage of elderly women living in poverty of any industrialized nation. That is a national disgrace, and, incidentally, we are 18 percent when you compare that with Canada, our neighbor, 3.2 percent of elderly single women living in poverty; In Germany, it is 2.4 percent; in France, where I have lived, it is 0.8 percent, and here in the United States, 18 percent. That is a significant statistic that we need to pay attention to.

Women are especially vulnerable to economic insecurity in old age for a number of reasons. First of all, the gender gap in wages. This is our number one issue in Business and Professional Women-USA. We have been communicating with our representatives on the Hill and educating others about the persistent pay inequity in America. The U.S. Census Bureau estimates that women earn on average currently 74 cents for every dollar their male counterpart is paid. That is exacerbated if you are an African-American woman, your average falls to 64 percent, and if you are a Latina, it bottoms out at 53 percent. And, incidentally, for those women of color, those statistics got worse this last measurement period instead of better.

A recent joint study released by IWPR shows that that amounts to an aggregate loss for women of $200 billion every year simply due to the wage gap. That pay inequity is exacerbated, obviously, in the retirement years, because the formulae, both for Social Security and pensions are tied to women's earnings, because women have a median income of $21,883; that is for full-time working women. Half of all those women work in traditionally female, relatively lower paid jobs. This occupational segregation problem is still with us with very little pension coverage. Women are also more likely, of course, to work in part-time or minimum wage jobs, again, without pension coverage. These lower earnings mean that their pension benefits will be far lower.

Another factor, of course, is lifespan. Ms. Heinz touched upon the fact that lifespan, while it sounds like a blessing that women live longer than men, when you have to stretch a smaller nest egg over longer years, it often means that those women will be living in poverty or close to it.

Marital status is another important factor. Far more women in their retirement years are living alone as widows or as divorcees. In general, elderly men are not living alone; in much smaller percentages, they tend to be living alone. So, a single, elderly woman today is twice is likely as an elderly man to be living in poverty. These are important trends that we must pay attention to. Another exacerbating factor in all of this, as has been mentioned, is that women as principal caregivers leave the workforce for a substantial gap in their work years, and that, again, affects their pension benefits.

Most women aren't lucky enough to even have a pension, regardless of its size. Women are clustered more often in those low wage or service or part-time jobs, and there are also more of them working for smaller businesses. So, a majority still do not have pensions at all. The type of pension plan is also important for women. There has been this marked shift from defined benefit plans to defined contribution plans, and overall that trend hurts women disproportionately for several reasons that are covered in my written testimony.

To be fair, the defined benefit plans don't solve all the problems that women face in retirement planning, and certainly inflation and all those other factors I mentioned are very important, but the annuitized format of those plans and their reliability and, importantly, the participation of employers are all features that are especially important to women.

So, we also feel very strongly, in BPW—as I said a third of our members are business owners. We feel that there really needs to be great attention to giving greater incentives to smaller businesses. Women-owned businesses being formed, as I mentioned, are this tremendous phenomenon in our economy, of women entrepreneurial ventures. They tend to be small businesses, often home-based businesses, in fact, and they need more incentives and more assistance to make it easier for these firms to offer defined benefit plans which will benefit everyone.

And I would just like to also add that we were very pleased to support the "SAFE" bill that Congresswoman Johnson and Congressman Pomeroy last year had advanced, and we hope that some of the framework that they had provided in that bill will also be considered as these bills evolve in committee and on the Floor. In addition, Senator Snowe's bill which had been carried by Congresswoman Kennelly, and I hope someone else in the House will be picking up the Comprehensive Women Pension Protection Act which does a great deal to help women by addressing gender inequities in the law—particularly with spouse, divorcee or survivor benefits.

So, thank you very much for listening to our perspective. We appreciate your attention.

[The prepared statement follows:]

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

Good afternoon. On behalf of Business and Professional Women/USA (BPW/USA), I want to thank the members of the Subcommittee and particularly Congressman Houghton and Congressman Coyne for inviting me today. I am Gail Shaffer, Chief Executive Officer 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 organizations 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. BPW/USA is a member of the National Women's Business Council, a bi-partisan Federal government advisory panel that was created to serve as an independent source of advice and counsel to the President, the Congress, and the Interagency Committee on Women's Business Enterprise. The mission of the Council is to promote bold initiatives, policies and programs designed to support women's business enterprises at all stages of development in the public and private sector marketplaces. While the National Women's Business Council has not officially taken a position on pension reform legislation before this committee, the "Comprehensive Retirement Security and Pension Reform Act" will benefit women-owned businesses—the fastest growing segment of our economy. This legislation grants relief from PBGC premiums for new small business defined benefit plans and eliminates IRS user fees for small business plans. The legislation increases portability, improves rollover provisions, and cuts administrative burdens. These provisions will benefit employers and employees alike. It is a positive first step toward ensuring that all Americans have a secure retirement.

However, more needs to be done. First, unlike the Retirement Savings and Opportunity Act in the Senate, the bill does not provide any tax incentives for small businesses, even to cover start-up administrative costs. Today, women entrepreneurs employ more people than the Fortune 500 and tax expenditures for their small businesses are too high. The bill also does not include an education provision to ensure that small businesses understand the full-range of pension options available to them. Often, the only resources for pension information are the salespeople from financial services companies who are trying to sell their services.

Second, the catch-up provision that allows up to a $15,000 contribution into a 401(k) will benefit women but only those women at the higher end of the wage scale. When you consider that only three percent of full-time working women earn over $75,000, the full benefits of this provision will be limited. More needs to be done for the average woman who earns significantly less.

Third, although, the New SIMPLES are a positive step toward the goal of expanding pension coverage, they could have a regressive effect by discouraging employers from eventually offering employer-matching plans. This is due in part because the New SIMPLES do not include requirements to ensure significant employee participation across the wage scale in a given company, thus removing incentives for employers to negotiate with their employees.

The goal here today is to discuss meaningful pension reform that expands coverage, cuts costs and improves the retirement security for us all. I want to thank you for allowing me to share with you BPW/USA's particular area of expertise: the ways in which the pension system's current inadequacies disproportionately affect women. BPW/USA 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. We are pleased to work in partnership with organizations like the Women's Institute for a Secure Retirement (WISER) to take this message to the grassroots.

BPW/USA 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.

In fact, I would like to bring to the Committee's attention the disturbing fact that the United States has the distinction of having more elderly women living in poverty than any other industrialized nation.

Several factors contribute to the fact that women are especially vulnerable to economic insecurity in old age:

Women earn less. The U.S. Census Bureau estimates that women earn on average, 74 cents for every dollar a man is paid. If you are an African-American woman, that average falls to 64 percent. And if you are a Latina, it bottoms out at 53 percent. A recent joint study released by the AFL-CIO and Institute for Women's Policy Research estimates that the wage gap costs American women collectively more than $200 Billion every year.

As many of you are probably aware, pay equity is my organization's top priority. It is our top priority for one simple reason: no other single economic factor has a greater impact on the lives of working women. The wage gap effects nearly every facet of women's economic lives. It severely limits women's purchasing power. It means less money to put away into savings. It reduces retirement income, because both Social Security and traditional pension formulas are calculated based on earnings and the amount paid into the system. It also limits women's freedom, because women who might otherwise be able to afford to work fewer hours and devote that extra time to caring for young children or aging parents must instead work full-time and over-time just to keep up with the bills.

The wage gap is only one part of the tenuous economic picture for women. The median income for all working women in 1997 was $16,716 and for full-time women it was $21,883. Half of all women work in traditionally female, relatively lower paid jobs—without pension coverage. Women are also more likely to work in part-time and minimum wage jobs—again without pension coverage. The result of lower earnings means that women's pension benefits will be lower than those of men.

Another factor making women vulnerable 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 remain the principle caregivers for their families, taking care of not only their children but often their parents as well. The average woman spends 15 percent of her career outside the workforce compared to two percent of men. Again, fewer years in the workforce means lower pension benefits.

But most women aren't lucky enough even to have a pension, regardless of its size. As I mentioned, 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, as I have already mentioned, 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. Again, three out of four working women earn less than $30,000 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 median benefit amount that a woman has accumulated in her 401(k) is only $7,000 compared to $20,000 for a similar man. 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 were so very pleased last year when Congresswoman Nancy Johnson, along with her colleague, Congressman Earl Pomeroy, decided to address this problem and introduce the Secure Assets For Employees Plan Act in the 105th Congress. The SAFE Plan Act provided a framework to enable smaller employers to offer real pensions to their workers. The bill guaranteed a minimum defined benefit, which as I have stated is so critical for women. It also introduced portability to these benefits, like the Portman-Cardin bill, so that when an employee leaves her job, she can take her retirement savings with her.

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 of 1999—S. 132. Senator Olympia Snowe, with whom we have worked closely over the years, introduced this bill in the Senate. Representative Kennelly sponsored the bill in the House in the 105th Congress and it is our hope that another Member of Congress will take the lead on this legislation shortly.

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.

Chairman HOUGHTON. Thank you very much, Ms. Shaffer.

Mr. Pool.

STATEMENT OF RAY POOL, ADMINISTRATOR, OKLAHOMA STATE EMPLOYEES DEFERRED COMPENSATION PROGRAM AND CHAIRMAN, LEGISLATIVE COMMITTEE, NATIONAL ASSOCIATION OF GOVERNMENT DEFERRED COMPENSATION ADMINISTRATORS, LEXINGTON, KENTUCKY

Mr. POOL. Thank you, Mr. Chairman, and good evening. First of all, I would like to thank you for holding the hearings today, and I appreciate your dedication to such an important issue. My name is Ray Pool; I am administrator of the Oklahoma State Employees Deferred Compensation Program. I am here today as chairman of the Legislative Committee of the National Association of Government Deferred Compensation Administrators, referred to as NAGDCA throughout my testimony.

Mr. Chairman, included with my written testimony is a letter signed by 17 public interest groups representing both governmental employers and employees in support of the provisions I will talk about today. I respectfully request that this letter be included for the record.

NAGDCA represents 48 States and State plans. These States have under the auspices of a 5,000 local government deferred compensation plans. NAGDCA's membership includes over 100 industrial members from insurance and annuity companies, mutual fund companies, brokerage firms, and money management firms. Both the public and private sector members of NAGDCA work together to improve governmental retirement plans of the sharing of information on investments, marketing, and administration.

Our members administer State and local government plans that are regulated under section 457 of the Internal Revenue Code. Approximately 10 States have 401(k) plans as they were grandfathered in as part of the 1986 Tax Reform Act which prohibited State and local governments from creating new 401(k) plans. These plans supplement State and local defined benefit programs. In other words, they work together to provide that nice foundation for the three-legged stool, and they provide a convenient vehicle for public employees across the country the save for retirement.

A snapshot of membership would show that social workers, road crew workers, all the way to governors of these locales participate in these plans. Governmental 457 plans are funded by employees who contribute a portion of their salary into these deferred compensation plans. In a limited number of cases, States also makes contributions through a match. Estimates of participation show that over 8 million Americans save for retirement in 457 plans, and our members design and implement programs for their State and local jurisdictions aimed at increasing employee contributions and providing investment education so good savers can become good investors.

Over the past 9 years, assets have nearly quadrupled, now exceeding over $75 billion. In short, 457 deferred compensation participants have taken the responsibility to provide additional retirement income for themselves and their families. NAGDCA has reviewed the administration budget proposals on pension reform and H.R. 1102, the Portman-Cardin bill. Both would enhance portability in public sector to fund benefit plans and allow workers to the deferred compensation with them when they change jobs.

H.R. 1102 expands on the administration proposals and provides more extensive portability between public and private deferred compensation plans. H.R. 1102, with its easier rollover rules allows full transfer among 403(b), 457, 401(k), and IRAs upon termination of service. This change will allow retirement savings to follow employees as they change jobs between the public and private sector. NAGDCA believes H.R. 1102 achieves the important goal of parody between the public and private sector.

Additionally, H.R. 1102 provides other enhancements to the public deferred compensation plan that NAGDCA supports. The bill provides that the recipient of 457 assets, pursuant to a qualified domestic relations order, be responsible for the taxes. This is a change from the current law which is somehow to understand where the participant is responsible for taxes even in the event a former spouse is awarded the assets in a divorce.

H.R. 1102 would allow public employees to purchase service credits with any of their deferred compensation dollars. We think this is appropriate as these plans are supplement and work together with the defined benefit programs. The bill would allow 457 participants to change the time and amount of their retirement payments. Under current law, 457 retirees must make an election as to when they want to receive the money and how much they want to receive, and once their payments begin, it is very difficult to have that changed.

NAGDCA believes the Portman-Cardin bill, H.R. 1102, is well thought out. The changes mentioned here as well as others included in the bill, will simplify administration and make the plans easier to understand for participants.

NAGDCA members are a good example of how governments and the financial services segments of private industry can work together to promote and enhance employee retirement savings for ordinary workers. The teachers, police, nurses, and others who work and save everyday, these employees are not controlling stockholders; they are not corporate insiders; they are not highly compensated in the technical or figurative sense of the term. Yet all these people will benefit from the increased flexibility and practical administration that is encouraged by these proposals.

NAGDCA members will continue their efforts to encourage people to save for retirement and looks forward to working with your subcommittee to achieve the goal of a more financial secure retirement for all Americans. Thank you for the opportunity to testify today.

[The prepared statement follows:]

Statement of Ray Pool, Administrator, Oklahoma State Employees Deferred Compensation Program, and Chairman, Legislative Committee, National Association of Government Deferred Compensation Administrators

Good afternoon, Mr. Chairman and Members of the Subcommittee. My name is Ray Pool. I am the Administrator of the Oklahoma State employees deferred compensation program.

I am here to today as Chairman of the National Association of Government Deferred Compensation Administrators' (NAGDCA) Legislative Committee. With me are John Barry, Assistant Attorney General for the State of Maryland and NAGDCA Board Member, and Susan J. White, NAGDCA'S Legislative Counsel.

Mr. Chairman, I also bring a letter signed by seventeen public interest groups, representing both governmental employers and employees, in support of the provisions I will talk about today. I respectfully request that this letter be submitted for the Record.

NAGDCA represents 48 States and State plans. These States have, under their auspices, over 5,000 local Government Deferred Compensation Plans. NAGDCA also represents approximately 100 Industrial Members such as Insurance and Annuity Companies, Mutual Fund Companies, Brokerage Firms and Money Managers. Both the public and private sector members of NAGDCA work together to improve Governmental Retirement Plans through sharing of information on investments, marketing and administration.

Our members administer State and local government plans that are regulated under Section 457 of the Internal Revenue Code (IRC). These plans, which supplement State and local defined benefit programs, provide a convenient vehicle for public employees across the country to save for retirement. A snapshot of membership would show that Social Workers, Road Crew Workers-all the way to the Governor-participate.

Governmental 457 plans are funded by employees who contribute a portion of their salary into these deferred compensation plans. In a limited number of cases States also make contributions through a match. Estimates of participation show that over 8 million Americans save for retirement in 457 plans. NAGDCA members design and implement programs for their State and local jurisdictions, aimed at increasing employee contributions and providing education so good savers can become good investors. Over the past nine years plan assets have nearly quadrupled; 457 plan assets nationwide now total over 75 billion dollars.

In short, 457 deferred compensation participants have taken the responsibility to provide additional retirement income for themselves and for their families. Additionally our members also administer State and local government 401(k) plans. Approximately ten States have 401(k) plans, as they were Grandfathered as part of the 1986 Tax Reform Act which prohibited State and local governments from creating new 401(k) plans.

NAGDCA supports the following changes to allow for portability of plans between employers, simplification of the administration of public plans, and the enhancement of overall retirement savings for employees nationwide:

- Allow for rollovers between public and private sector defined contribution plans, including 457, 401(k), 403(b), 401(a) plans and IRA's upon separation from service;
- Allow for indexation of catch-up provisions for any plan that currently has a catch-up option;
- Simplify the calculation for determining the maximum contribution limit for 457 plans;
- Allow public employees to purchase service credits with any of their defined contribution plan dollars.
- Implement less restrictive rules for 457 retirement plans to allow employees to change the time and amount of their retirement payments. For example, a 457 retiree elects to receive $250 a month. Under current law he or she is prohibited from changing that amount, even in the event of changing life circumstances-such as an increase in insurance premiums. In comparison, 401(k) and other retirees can adjust their distributions at any time. NAGDCA supports this change that would put government workers on a more equal footing with employees in the private sector.

NAGDCA has reviewed the president's budget proposals on pension reform, and H.R. 1102, the recently introduced Portman-Cardin bill. The President's proposal includes some key provisions for Public Plans. H.R. 1102 expands on the Administration's proposal providing a more comprehensive approach to Retirement Savings and

Planning for State and local employees. The Portman-Cardin Bill is well thought out. It enhances benefits while making these plans easier to administer for the employee's advantage. H.R. 1102 achieves the important goal of parity between Public and Private Retirement Savings Plans and provides for portability and flexibility by including the provisions we just mentioned.

NAGDCA does not believe that tax laws for public and private sector plans need to be or should be exactly the same. NAGDCA does believe that Government Employees Saving for retirement ought to receive roughly equal treatment and tax benefits as employees in the private sector. An excellent example of this is H.R. 1102's removal of the constructive receipt rule for 457 plan distributions, which congress eliminated for private sector plans many years ago. Removal of this rule will eliminate irrevocable elections that people do not understand and give them a rule that they do understand: you owe taxes when you receive the money.

It's important to remember that all rules must work together to promote sensible and practical administration. For example, H.R. 1102, with its easier rollover rules, allows full transfer among 403(b), 401(k) and 457 plans. This change will allow Retirement Savings to follow employees as they change jobs and go from the public to the private sector and vice versa.

One final note-NAGDCA and NAGDCA members are a good example of how governments and the financial services segment of private industry can work together to promote and enhance Employee Retirement Savings for ordinary workers-the teachers, police, nurses and others who work and save every day. These employees are not controlling stockholders; they are not corporate insiders; they are not highly compensated in the technical or figurative sense of the term. Yet, all these people will benefit from the increased flexibility and practical administration that is encouraged by these proposals. NAGDCA looks forward to working with your Subcommittee to achieve the goal of a more financially secure retirement for all Americans.

Thank you for the opportunity to testify before this Subcommittee today.

Chairman HOUGHTON. All right, thank you very much, Mr. Pool. Mr. Schneider.

STATEMENT OF WAYNE SCHNEIDER, GENERAL COUNSEL, NEW YORK STATE TEACHERS' RETIREMENT SYSTEM; ON BEHALF OF NATIONAL COUNCIL ON TEACHER RETIREMENT, NATIONAL ASSOCIATION OF STATE RETIREMENT ADMINISTRATORS, NATIONAL CONFERENCE OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS, AND GOVERNMENT FINANCE OFFICERS ASSOCIATION

Mr. SCHNEIDER. Thank you, Mr. Chairman. I am very appreciative of the opportunity to express support for H.R. 1102, the Comprehensive Retirement Security and Pension Reform Act introduced by Congressmen Portman and Cardin and for similar proposals that have been put forward by the President.

I am the general counsel of the New York State Teachers' Retirement System, one of the Nation's 10 largest public pension plans. We serve 300,000 active and retired public school teachers, the majority of whom are women. I am here on behalf of the National Council on Teacher Retirement, an association of 73 State and local retirement systems that serve more than 11 million public school teachers and other public employees. The other major public pension organizations, the National Association of State Retirement Administrators, NASRA, the National Conference of Public Employee Retirement Systems, NCPRS, and the Government Finance Officers Association, GFOA, join in these remarks.

There are many good things in H.R. 1102. Let me focus on those provisions of H.R. 1102 which affect State and local government retirement systems. First of all, we commend Representatives Portman and Cardin and the President proposing ways to expand pension portability options for State and local government employees.

With respect to rollovers, let me speak to that. Public sector employees currently have fewer opportunities to rollover pension money than private sector workers. This is because public sector employees generally have TSAs, that is tax-sheltered annuities under section 403(b), or 457 plans available to them which are subject currently to restrictive rollover rules. By contrast, individuals with 401(k) plans in the private sector have more rollover options, but public employees generally do not have 401(k)s, because Congress prohibited them in the Tax Reform Act of 1986.

H.R. 1102 would eliminate the restrictions that I have spoken of. A public schoolteacher, for example, who participates in a TSA and who takes a job in the private sector will be able to rollover TSA money into a 401(k) if her new employer makes one available and allows for the transfer. Similarly, when a State employee with a 457 plan moves to employment with a school district, he will be able to rollover the money in the 457 plan to the TSA under H.R. 1102.

The President's proposals treat TSAs in a similar manner but would permit rollovers from 457 plans to IRAs only. We would encourage the President to adopt the approach of H.R. 1102 and its broader scope. This will ensure that public employees with 457 plans only may have the same rollover rights as workers with TSAs.

With respect to the purchase of service credit, employees of State and local governments, particularly teachers, move from State to State during their careers. Under State laws, they frequently have the option of purchasing credit for their prior teaching service in the new system. In other words, they buy the time. Through such provisions, they are able to obtain a defined benefit pension reflecting a full career of public service when they finally retire. Sometimes these purchases, however, can be quite expensive. Existing law permits purchases with 401(k) money and money from other qualified plans. H.R. 1102 and the President's proposals would allow teachers and public employees to use money in TSAs and 457 plans to make these purchases, thereby, giving them a greater range of assets from which to draw upon in order to enhance their defined benefit pensions.

Let me turn to the defined benefit dollar limits. Virtually all State and local government plans are defined benefit plans, and, as such, are subject to the dollar limits in section 415(b) of the Internal Revenue Code on the benefits they provide. These limitations are, in fact, quite complicated, as we all know, and impose cumbersome administrative burdens on public plans. It is often difficult to predict in advance whether the 415(b) limitations will impact a given participant, and, in fact, the overwhelming majority of participants are ultimately not impacted by the limitations, in any event, resulting in a lot of wasted administrative effort. On the other hand, the uncertainties created by these complex rules have an impact on members when they make retirement decisions. Depending upon their particular age and circumstances, they might find their promised benefits capped by an unforeseen application of the limit. This is something they cannot foresee. They don't understand the complexities of these rules.

While the administration has not proposed liberalizing the limits, we applaud Representatives Portman and Cardin for taking the initiative in this area. We also commend the Congressmen for proposing an increase in the compensation limits under 401(a)(17) as well as for proposing the maximum annual limits for TSAs and 457 plans be increased. Many public employees participate in these important savings vehicles which allow them to voluntarily contribute a portion of their salaries on a tax-deferred basis. Again, while the President does not include similar proposals, we urge him to support them as in your bill.

In summary, we are grateful for the strong leadership that has been shown in this area. Pensions are a complex area, and we appreciate the dedication that you have shown in advancing retirement savings in the Nation, and I thank you for the opportunity to testify.

[The prepared statement follows:]

Statement of Wayne Schneider, General Counsel, New York State Teacher's Retirement System; on behalf of the National Council on Teacher Retirement, National Association of State Retirement Administrators, National Conference of Public Employee Retirement Systems, and Government Finance Officers Association

I am pleased to have the opportunity to express support for H.R. 1102, the Comprehensive Retirement Security and Pension Reform Act, introduced on March 11, 1999, by Congressmen Rob Portman and Ben Cardin and similar pension provisions put forward by the President. Those proposals were announced by Vice-President Al Gore on February 11, 1999.

I am General Counsel of the New York State Teachers' Retirement System, one of the Nation's 10 largest pension plans. We serve over 300,000 active and retired public school teachers. I am here on behalf of the National Council on Teacher Retirement, an association of 73 state and local retirement systems that serves more than 11 million public school teachers and other public employees. The other major public pension organizations, the National Association of State Retirement Administrators (NASRA), the National Conference of Public Employee Retirement Systems (NCPERS), and the Government Finance Officers Association (GFOA) join in these remarks. In addition, I have attached to this statement a letter from these organizations and other groups representing the states, local governments, and employee associations in support of H.R. 1102 and the President's proposals that address public pension plans and their participants.

Among other things, H.R. 1102 and the President's proposals will:

- Expand pension coverage, especially for workers of small businesses;
- Enhance retirement security of women;
- Increase portability; and
- Simplify the pension system.

I will focus my remarks on the key provisions in H.R. 1102 and the President's proposals which affect state and local government retirement systems.

Expanding Pension Portability for State and Local Government Workers

We commend Reps. Portman and Cardin and the President for proposing ways to expand pension portability options for state and local government employees. They would:

- Allow certain types of rollovers among various types of retirement plans; and
- Permit the use of money in Section 403(b) tax sheltered annuities (TSAs) and Section 457 deferred compensation plans (457 plans) for purchases of service credit in governmental defined benefit plans.

Rollovers. Public sector employees have fewer opportunities to rollover pension money when they change employers than do private sector workers. This is because public sector employees generally have TSAs or 457 plans available to them, which are subject to restrictive rollover rules. By contrast, individuals with 401(k) plans, which are commonly available in the private sector, have more rollover options. Public employees generally do not have 401(k)s because Congress prohibited states and localities from offering them in the Tax Reform Act of 1986. (Any 401(k)s set up before then are grandfathered.) H.R. 1102 would eliminate these restrictions. A public school teacher who participates in a TSA and who takes a job in the private sector could rollover the TSA money into a 401(k) if her new employer makes one available and allows the transfer. By the same token, if a state employee with a 457 plan moves to employment with a school district, he will be able to roll the money in the 457 plan to a TSA. The President's proposals treat TSAs in the same manner, but would permit rollovers from 457 plans to IRAs only. We would encourage him to adopt H.R. 1102's broader scope. This will ensure that public employees who have access to 457 plans only may have the same rollover rights as workers with TSAs.

403(b) and 457 Money for Purchases of Service Credit. Employees of state and local governments, particularly teachers, often move from one state to another during their careers. Under state law, they frequently have the option of purchasing service credit in their defined benefit plan in order to obtain credit for their teaching service in another state (i.e., they can "buy" the time). Through such purchases, they are able to obtain a pension reflecting a full career of public service when they finally retire. Sometimes the purchases are quite expensive, however. Existing law permits purchases with 401(k) and money from other qualified plans. As noted above, few public employees have access to 401(k)s. H.R. 1102 and the President's proposals would allow teachers and other public employees to use money in TSAs and 457 plans to make the purchases, allowing them a greater range of assets from which to draw in order to enhance their pension benefits.

RESTORATION OF MAXIMUM PENSION LIMITS FORMERLY IN EFFECT

Defined Benefit Dollar Limits. Virtually all state and local government plans are defined benefit plans and, as such, are subject to the so-called "dollar" limitations of IRC Section 415(b) or the benefits they provide. These limitations are, in fact, quite complicated and impose cumbersome administrative burdens on public plans. It is often difficult to predict in advance whether the 415(b) limitations will impact a given participant's benefit. Moreover, the overwhelming majority of public employees ultimately are not affected by the limitations in any event, resulting in wasted effort. The uncertainties created by the limitations also present potential traps for plan participants who cannot be expected to be familiar with the complexities of the federal tax laws as they make their retirement decisions. Depending upon their particular age and circumstances, they might find their promised benefits capped by an unforeseen application of the limitations. While the Administration has not proposed liberalizing the limits, we applaud Representatives Portman and Cardin for taking the initiative in the area.

Liberalization of Other Limits. We also commend the Congressmen for proposing an increase in the compensation limits under IRC Section 401(a)(17) as well as the maximum annual limit for TSAs and 457 plans. Many public employees participate in these important savings vehicles which allow them to voluntarily contribute a portion of their salaries on a tax-deferred basis. While the President does not include similar provisions in his proposals, we urge him to support them for the reasons stated above.

H.R. 1102 contains some important provisions directly affecting 457 plans, which are widely supported by public sector organizations. My colleagues who administer those plans will be presenting a separate statement on these proposals.

In summary, we are grateful for the strong leadership of Reps. Portman and Cardin and the President in the area of pension reform. Pensions are a complex area and we appreciate the dedication that they have shown in advancing retirement savings in the Nation. I would be pleased to answer any questions.

Chairman HOUGHTON. Well, thank you, Mr. Schneider, and thank you everybody. We will now go on to questions. I will turn to Mr. Coyne.

Mr. COYNE. I have no questions.

Chairman HOUGHTON. No questions, okay. Mr. Portman.

Mr. PORTMAN. Just quickly, David Strauss talked about his father; I need to talk about mine just briefly, if that is okay, Mr. Chairman. My father is in the back of the room over here; he has been patient, as all of you have, and I wasn't going to talk about this, but he showed up. He is here visiting today, and about 37 years ago he started his own business having been with a bigger company. He took all the risks, was heavily in debt, and wanted to start a pension plan for his employees, and he started with four employees, and within six years had a defined contribution plan in place, and only later took on a 401(k). Today, there are mechanics who are retiring with over $400,000 in those accounts who turned a wrench their whole lives, and that is one of the reasons I am here and in this, and so I am delighted he is here tonight to be able to tell him that we appreciate what he does, and we hope that more small employers can be able to do that with these changes.

Ms. Mazo, thank you so much for your patience and brevity. You aren't going to beat a dead horse; I probably shouldn't beat a dead horse either. I really appreciate the work that you all have done in multiemployer plans. I know Jerry is going to get into this more with you; I hope he will, but I really appreciate working with Mr. Weller, Mr. Cardin, and others and your support of the bill.

I will beat a dead horse just a second, Ms. Shaffer. I really appreciate your support of so many provisions in this specific bill. Let me just raise a couple of things quickly for the record. You didn't say this in your oral testimony, but in your written statement I saw you didn't get that we put the tax credit in. We didn't have it in last year; it is in now for start-ups, and you were supportive of including that; it is included now.

Ms. SHAFFER. I amended it in my oral.

Mr. PORTMAN. Great, okay. Second, on this education idea, we do have education provisions. Take a look at those; see what you think of them. I don't want to get into a lot of detail about it, but we do have retirement education for employer provided plans. It picks up on the Graham-Grassley language from last year, and it is a very important part, as I said earlier, of the overall effort here. See what you think of that. We also put in some other provisions. It is an eligible expense under the tax credit provisions to try to encourage small businesses to provide education. That was put in specifically for that reason. So, I think we do address some of your concerns in that area that you may not have seen, because it is in the minutia, but let us know. The third issue is you make the statement that only women at the high end are going to benefit from the catch-up, and it is really not that helpful. I just say respectfully—anybody can use it. I mean it is true—you said very few women make over $75,000, that some women are not going to have the disposable income for them to be able to do it, but if you are going back into the workplace, you want to build up that nest egg and you are making $30,000, $40,000 a year, this may be a pretty good deal for you depending on the plan and the match and so on, you may want to contribute more. Second, and this is very important to remember, and, again, there is a lot of disagreement over this, it is subject to the non-discrimination rules. So, to the extent a woman is making an additional $5,000 catch-up, everybody else benefits. I think that gets lost sometimes in this.

Now, as you know, in the Senate bill, I think it is the Roth bill, the non-discrimination rules don't apply, and a lot of people maybe in this room would think they shouldn't apply to the catch-up here, but we did apply them, therefore, it will benefit, I think, a lot of women who will just use it for themselves who may not be high income but realize they need to get some retirement savings in place with proper education, but also it is going to help everybody because of non-discrimination rules. So, I just wanted to, go over that, again, because I appreciate your support of the overall emphasis and so on, but those are three areas where I think we need to clarify the record. And working with State employees has been great these last two years; thanks for your help, what you do to educate your members.

Mr. Schneider, I would imagine you have mostly women among your members.

Mr. SCHNEIDER. A majority are women, yes.

Mr. PORTMAN. I don't know, if you might just want to comment about how you think this bill will help the special retirement needs of women which we have talked about a lot today?

Mr. SCHNEIDER. Well, I think, certainly, the portability provisions, for example. We have women who move out of the workplace, who move out of teaching to raise a family, and they do come back, and providing increased portability so they can buy back their service will be very, very helpful to our members. Certainly, women do move from State to State during the course of their lives, and where they can buy the service credit and be able to use other retirement money to build up their defined benefit pension, because that certainly is the most valuable pension right you can have. Increasing that portability, increasing that flexibility will be very important to them.

Mr. PORTMAN. Ms. Calimafde, thanks for your help with helping us identify some women out there in small businesses who were impacted by this and who cared about it, and you talked a lot about the catch-up provisions. You had three specific reasons you thought this bill would help women, entrepreneurs, and other small business people. Could you just touch on the limits issue that has been addressed earlier by Treasury and others?

Ms. CALIMAFDE. I think—and this sort of goes to what you were saying—very often, in the 401(k) plan, you will have two-earner couples, and the couple may be earning together, maybe $60,000, $70,000. I don't think anybody would call that rich; they are making that much, because both of them are working so hard. But very often, what happens is the couple decides that one spouse will use a lot of their salary to put into a 401(k) plan, and, quite often, the 15 percent limit cuts into that. I noticed H.R. 1102 would change that 15 percent limit to 25 percent, and I think there are cases where 15 percent of $50,000 is less than what the couple wants to put away. And H.R. 1102 also raises the $10,000 limit up to $15,000. I think that that kind of situation is not unusual out there, and, very often, one of the spouses may have been out for a certain amount of time, bringing up children, whatever, then rejoins the workforce and then the couple decides they really need to save quickly.

Mr. PORTMAN. Thank you. Thank you, Mr. Chairman. Thank all of you for your testimony.

Chairman HOUGHTON. OK, Mr. Weller.

Mr. WELLER. Thank you, Mr. Chairman. First, I want to echo the comments that Rob Portman made regarding the need for catch-up mechanisms. Whenever I think of the need for catch-up, I think of my sister, Pat, who took time off of work for a number of years to be home with the kids, and, of course, during that time, they had one breadwinner in the household rather than two, and, of course, when you have little children, there is a lot of expenses let alone have money leftover to set aside for savings, and once a working woman goes back on a payroll, we need to give her the opportunity to make up those missed contributions, and I certainly hope when the final packages reaches the President, that there will be a catch-up mechanism.

I also believe there is a need to, particularly, to help families where you have, perhaps, out of a working couple, one of them is not covered by a 401(k) or, perhaps, is staying home with the kids, why not allow that couple to be able to set aside more than what they are limited just for one person in their 401(k), essentially a homemaker 401(k), perhaps, setting aside twice as much under that. So, I think that is something we need to be taking a look at.

But, because of limitations on time, I would like to address a question to Ms. Mazo here regarding section 415; of course, an issue I have heard from a lot of the families who have a building trades person in the family and of course frustration after working many, many years are finding that these limits have reduced what they expected to obtain from their multiemployer fund, and I know in researching the section of the 415 compensation limits, originally they were essentially put in place to prevent corporate CEOs and executives from feathering their own pensions. And, of course, as time has gone by, the only people still under these 415 limitations are building trades folks and multiemployer pension funds, and that is why I really appreciate your testimony and the partnership we have had over the last couple years working to address this issue and working to help folks back home who have calluses and work hard and get their hands dirty and work hard for many, many years.

I was wondering if you can explain, perhaps, or give an example or from a personal standpoint, maybe of an individual, what these limitations mean? Of course, the legislation we have been working on the last couple of years, which enjoys bipartisan support, would remove totally the limitations for individuals on these section 415 multiemployer funds. I was wondering if you can just give an example of what this would mean to an individual—?

Ms. MAZO. Thank you, Representative Weller. We very much appreciate the help you have been giving us over the years on this. You may have been hearing from some of the same people we have been hearing from on that. I put out an email within my company today asking for some examples in carefully targeted States, and I will just kind of go through a few of them.

An example of a racetrack employee in Maryland—his pension would have been $1,700 a month after 36 years of work. His pay was only $1,600 a month at that point, so here is a person who is losing $1,200 a year which is just a little bit less than what David Strauss' father is living on, and he is losing it because of the 415 pay limits; secretaries—$25,000, $30,000 a year secretaries in Cleveland who will lose about $4,000 a year of their pension because of the limits; ironworkers in Iowa making $20,000, $21,000; that is one of the plans that have just started moving into having to have benefits cut because of 415; laborers in Ohio losing $2,000 to $6,000 a year from the pensions; bakery workers in Ohio losing several thousand a year because of 415, and there is one that kind of really always grabs me when I think of this example, and it is something that is covered by your bill. It is not yet addressed in the administration bill, and it has to do with the way the early retirement limits as they are currently structured affect people who need to take early retirement largely because of the nature of their work.

Carpetlayers, think of people who—it is a plan I like the name of, it is called resilient floor. It sounds nice, but it is people who lay linoleum and carpets and tiles, and they will spend—a man who can spend 25, 30 years on his hands and knees everyday, laying down—tacking down carpet and making sure it is neat. Somebody who goes into this kind of trade at the age of 20 or so, after 25 or so, 30 years is ready to retire, but because he may be only 45, 50 years old, his benefit is cut, and we have an example of a carpet layer who retired after 25 years—this is somebody from the midwest—25 year on his knees; his pension is going to be cut from $36,000 a year to $26,000 a year.

These are the kinds of people that we are trying to help, and we really appreciate the help that you have been giving and that all of you who are sponsoring H.R. 1102 are already giving for this.

Mr. WELLER. Well, those are good examples. When this issue first came to my attention a few years ago, it was the spouse of a cement finisher, and she goes, "You know, my husband leaves the house at 6:00 in the morning; comes home tired every night, and he has been doing it for 35 years." Now, I have poured some cement, not many times, but a few times when I was growing up on the farm; it is back-breaking work, and I can only imagine what it would be like to do it every day for 35 years, and, of course, they work hard, and in good times they have the opportunity because of—you know, work a little overtime, and, of course, that means more money is going into the pension fund because of the check off on their paycheck, and with these current limitations, they are essentially denied that opportunity to get the benefit of putting in those extra hours, and that is why I believe this legislation is so important, and I hope it is in the final package that the President signs into law. So, thank you, Mr. Chairman.

Chairman HOUGHTON. OK, thank you. Well, everybody, it is getting late. [Laughter.]

Thanks very much; we are all done.

Ms. CALIMAFDE. Thank you, sir.

Ms. MAZO. Thank you.

Ms. SHAFFER. Thank you.

[Whereupon, at 6:59 p.m., the hearing was adjourned.]

Statement of AlliedSignal Inc.

Thank you for this opportunity to express the support of AlliedSignal and its employee-owners for proposed legislation that would enhance retirement savings by giving employees the option to reinvest dividends earned on company stock held in an employee stock ownership plan (ESOP). We are pleased that this proposal is included in H.R. 1102, The Comprehensive Retirement Security and Pension Reform Act of 1999, and is supported by The ESOP Association, The U.S. Chamber of Commerce, the Association of Private Welfare and Benefit Plans (APPWP), The National Association of Manufacturers and Financial Executives Institute.

The AlliedSignal Savings Plan is one of the most generous in the country, and was featured as such in USA Today (Nov. 24, 1997). New employees may begin participating as soon as they are hired. After one year, we match 50% of employee contributions, and after 5 years we match 100% of employee contributions up to 8% of compensation.

Our Savings Plan is an ESOP as it is primarily intended to be invested in employer stock. ESOPs provide an efficient means of accumulating assets for retirement and an ownership interest in the employer. We believe strongly in employee ownership which is why we contribute company stock to the Savings Plan to match employee contributions.

AlliedSignal employs 70,500 people worldwide. Employees are the single largest group of our shareholders, owning approximately 11% of the company. We take pride in that and want that percentage to increase even more. Our employee-owners are building wealth and sharing in the growth and success of the company.

In fact, we have 121 employees with account balances over $1 million, and over 3,500 with account balances over $250,000. Most of these are not company executives, but rather employees at various salary levels who save year after year, and who benefit from our generous matching contribution.

There are 11 investment options for employees to choose from for their own contributions. These include bond funds, equity funds and various asset allocation funds, as well as a company stock fund. For many years we have been providing financial investor information to our employees and holding financial counseling seminars for them at no cost to help them make educated investment decisions.

Employee investment decisions are entirely up to them. We do not encourage or discourage employee investments in company stock. In our communications with employees we stress the importance of having a diversified portfolio.

Over the years Congress has enacted pro-ESOP legislation to encourage employers to establish and maintain ESOPs. One such benefit, which we utilize, allows companies under certain circumstances to deduct dividends paid on company stock held in the ESOP (Section 404(k) of the Internal Revenue Code). The availability of this deduction was a significant factor in AlliedSignal's decision to increase its matching contribution in 1987 from 50% to 100% of each dollar contributed, up to 8% of compensation after 5 years. This increase has resulted in greater retirement savings for our employees.

But in order to take the dividend deduction, the law mandates that we pay dividends to plan participants in cash—passing them through the Savings Plan directly to the participants. Our employees routinely complain when they receive their dividend checks. They believe that the dividends belong in the Savings Plan where they could grow for retirement. And as you well know, dividends that are reinvested in a savings plan would over time provide a greater amount to tax at retirement.

We support efforts to increase retirement savings and avoid unnecessary leakage in the private retirement system. Why encourage current spending when there is such a significant need to increase retirement savings?

The Internal Revenue Service has ruled that employers may provide for the equivalent of automatic reinvestment—but only if they jump through administrative hoops, and create a structure that is complex and difficult to understand and explain to employees. And to complicate things further, the IRS does not allow all employees to qualify for the automatic reinvestment equivalent.

Legislation that would allow employers to provide directly for dividend reinvestment, without the need for IRS rulings, regulations and paperwork would vastly simplify the system, and provide equal treatment for all employees. Many AlliedSignal employees have written to their congressional representatives in support of the legislation.

We applaud Chairman Houghton for holding this important hearing and giving AlliedSignal and its employee-owners an opportunity to voice their support for enhanced retirement savings. We also applaud Congressmen Portman and Cardin for including the ESOP dividend reinvestment proposal in H.R. 1102. There continues to be strong bipartisan support for the ESOP proposal in both the House and Senate. We urge the Subcommittee to act on this legislation at the earliest opportunity.

March 22, 1999

The Honorable Amo Houghton
Chairman, Subcommittee on Oversight
House Committee on Ways and Means
Washington, D.C. 20515

Dear Mr. Chairman:

It is our understanding that the House Subcommittee on Oversight will review proposals to enhance our nation's retirement policies, particularly those provisions that were included in recent proposals put forth by members of the Ways and Means Committee and the Administration at a hearing on March 23, 1999. The national organizations listed above, representing state and local governments, public employee unions, public retirement systems, and millions of public employees, retirees, and beneficiaries, support public pension provisions contained in the Comprehensive Retirement Security and Pension Reform Act of 1999 (H.R. 1120), sponsored by Representatives Rob Portman, Benjamin Cardin and others, and provisions in the Administration's fiscal year 2000 budget proposal. Such proposals would strengthen the retirement savings programs of public employers and their employees throughout the country.

Both H.R. 1102 and the Administration's FY 2000 budget proposal would enhance portability in public sector defined benefit plans and allow workers to take their deferred compensation and defined contribution savings with them when they change jobs. H.R. 1102 would provide additional enhancements to portability and pension simplification that we support. H.R. 1102 would provide more extensive portability between all defined contribution and deferred compensation plans. It would also provide greater clarity, flexibility and equity to the tax treatment of benefits and contributions under governmental deferred compensation plans. Finally, it would simplify the administration of and stimulate increased savings in retirement plans by increasing limits that have not been adjusted for inflation and are generally lower than they were fifteen years ago, repeal compensation-based limits that unfairly curtail the retirement savings of relatively non-highly paid workers, and allow those approaching retirement to increase their retirement savings.

In particular, we support the following provisions contained in these proposals:

- Permit funds from 403(b) and 457 plans to be used to purchase permissive service credits in public sector defined benefit plans, as is currently permitted within other defined contribution plans;
- Allow rollovers of retirement benefits to and from 403(b) and 457 plans when employees switch jobs;
- Allow greater flexibility in 457 distributions;
- Provide equitable tax treatment to Section 457 plan distributions made pursuant to a domestic relations order.
- Remove the compensation-based limits with regard to all retirement plans;
- Restore the increased annual limits on contributions to defined contribution plans, the annual benefit limits for defined benefit plans, and the amount of compensation that may be taken into account under qualified retirement plans; and Increase and index the current catch-up contributions, and allow catch-up contributions under all salary reduction plans for anyone age 50 and older.

All of these provisions would help employees build their retirement savings, especially those employees who have worked among various public, non-profit and private institutions. We appreciate that many of the proposals were included in the President's FY 2000 budget, and that all of them were encompassed in the comprehensive bipartisan legislation introduced by Representatives Portman and Cardin. Our organizations applaud the leadership members of the House Oversight Subcommittee and Ways and Means Committee have shown on public pension issues and are hopeful you will have similar interest in these meaningful proposals.

If you have questions or need additional information, please contact our legislative representatives:

Ed Jayne; American Federation of State, County and Municipal Employees; 202/429–1188

John Stanton; California State Teachers' Retirement System; 202/637–5600

Tim Richardson; Fraternal Order of Police; 202/547–8189

Tom Owens; Government Finance Officers Association; 202/429–2750
Barry Kasinitz; International Association of Fire Fighters; 202/737–8484
Tina Ott; International Personnel Management Association; 703/549–7100
Kimberly Nolf; International Union of Police Associations; 703–549–7473
Neil E. Bomberg; National Association of Counties; 202/942–4205
Susan White; National Association of Government Deferred Compensation Administrators; 703/683–2573
Chris Donnelan; National Association of Government Employers/International Brotherhood of Police Officers; 703–519–0300
Bob Scully; National Association of Police Organizations; 202/842–4420
Jeannine Markoe Raymond; National Association of State Retirement Administrators; 202/624–1417
Ed Braman; National Conference on Public Employee Retirement Systems; 202/429–2230
Gerri Madrid; National Conference of State Legislatures; 202/624–5400
Cindie Moore; National Council on Teacher Retirement; 703/243–3494
Frank Shafroth; National League of Cities; 202/626–3020
Daryll Griffin; National Public Employer Labor Relations Association; 202/296–2230
Clint Highfill; Service Employees' International Union; 202/898–3413

Statement of AMR Corporation, Fort Worth, TX

LUMP SUM PENSION PAYMENTS: IMPACT OF MORTALITY TABLE RULES

Introduction and Overview

This testimony outlines the comments of AMR Corporation on one aspect of how the Internal Revenue Code of 1986, as amended ("Code"), has been interpreted to complicate unnecessarily the sponsoring of defined benefit retirement plans for employees. Under the Code, "qualified" pension plans must offer a lifetime stream of monthly payments to plan participants, commencing upon retirement. Many pension plans permit participants to receive the value of this lifetime income stream in a single lump sum payment. In determining the "present value" of the lifetime income stream that is being cashed out, the period over which payments are expected to be made (the period ending with the assumed date of death) and the rate at which funds are expected to grow (the assumed interest rate) are necessary assumptions. The interest rate and mortality assumptions are therefore critical in calculating the lump sum value of lifetime benefits.

The Retirement Protection Act of 1994 (the "RPA") amended section 417(e) of the Internal Revenue Code to specify an interest rate that must be used to convert a pension to a single lump sum. The RPA also authorizes the Secretary of the Treasury to prescribe a mortality table for use in calculating lump sums under section 417(e) of the Code. We perceive no problem with the current statutory language itself, only with its implementation by the Internal Revenue Service.

The Internal Revenue Service has prescribed a mortality table for use by retirement plans. We have no objection to the table itself. However, we are concerned with the requirement that the table is to be used together with the mandatory assumption that half of the participants covered by the plan are male and half are female.

The requirement that a plan must assume that half its participants are male and half are female is highly questionable. The participation in many plans is dominated by one gender. It is an accepted scientific fact that females, as a class, have a longer life expectancy than males, as a class. Prescribing an artificial "gender mix," therefore, artificially and inaccurately enlarges or contracts the true average life expectancy of the work force covered by the pension plan unless the plan's gender mix is actually in balance. Assumed life expectancy is a major factor in calculating the amount of a lump sum distribution and in funding plans, regardless of whether a lump sum distribution benefit is offered.

These regulations, which appear at Treas. Reg. Section 1.417(e)–1(d)(2) (the regulations) (effective April 3, 1998), do twist actuarial reality by arbitrarily imposing a mandatory gender neutral mortality table on pension plans that permit lump sum payments. A directly relevant revenue ruling, Rev. Rul. 95–6, 1995–1 C.B. 80, 95 TNT 2–1, contains provisions that operate in tandem with the regulations. Under these rules, regardless of whether the participants in a qualified defined benefit pension plan are 90 percent female or 1 percent female, all lump sum payments must be calculated using a mortality table that assumes the plan population is 50 percent female and 50 percent male. We anticipate that more concern will be raised about this issue when companies with such plans realize that by 2000 all their lump sum distributions will have to be calculated based on this arbitrary gender assumption.

The legislative history accompanying the 1993 law mandating that Treasury create appropriate mortality tables gives no indication whatsoever that Treasury should issue such an arbitrary rule. If Treasury and the IRS are unwilling to change their rules to reflect actuarial reality, we hope that Congress will amend this law to mandate that Treasury utilize gender factors reflecting reality in those benefit plans where participant gender ratios are particularly unbalanced.

The Problem

A lump sum distribution from a qualified defined benefit pension plan to a participant is designed to be the "actuarial equivalent" of the payments that would otherwise be made during that participant's lifetime following retirement (or over the joint lifetime of the participant and the participant's spouse or other designated annuitant). To fund this lifetime income, a plan can use assumptions based on the expected lifetimes of its participants and can recognize, for example, that the covered participant population is 80 percent female and 20 percent male. The assumed mortality dates of participants is obviously a major factor in funding pension benefits, and it is a universally-accepted and well-documented fact that females will on average out-live males of the same age.

In contrast, if lifetime benefits are paid out in a lump sum, actuarial reality as described above for funding plans is ignored under current Internal Revenue Service rules. To determine the amount of lump sum payments, the regulations and Rev. Rul. 95–6 require plans to use a mortality table that assumes half the covered participant population is male and half is female. In the example given above (80 percent female and 20 percent male), the mandated 50/50 assumption artificially shortens the expected lifetimes of plan participants who are female, at least in comparison with the actual gender factors that can be used in the plan's funding. Nothing in the statute, which simply requires a "realistic" mortality table without reference to gender, mandates this arbitrary result.

Looking at this result from another perspective, the greater the gender disparity in favor of males, the more likely the plan will be underfunded if benefits are regularly paid in the form of a lump sum. Conversely, the greater the disparity in favor of females, the more the plan will become overfunded because expected lifetimes are artificially reduced.

Current Law

The Retirement Protection Act of 1994, enacted as part of the General Agreement on Trade and Tariffs, amended section 417(e) of the Code, as well as other sections of the Code and the Employee Retirement Income Security Act of 1974, as amended. GATT made two significant changes affecting the calculation of minimum lump sum payments. First, the statute redefined the applicable interest rate. Second, the legislation authorized the Treasury Secretary to prescribe a mortality table for use in calculating the present value of qualified plan benefits. Nothing in the legislative history of GATT indicates that Congress intended to preset a particular gender blend version of GAM 83.

Less than two months after passage of GATT, the Internal Revenue Service quickly published a mortality table in Rev. Rul. 95–6 for use under section 417(e). As provided in the statute, the Service's table uses the current prevailing commissioner's standard table for group annuities, or the 1983 GAM Table, which is a sex-distinct table (GAM 83). However, the ruling requires a 50/50 mandatory gender split assumption.

As mentioned above, the Secretary issued final regulations on both the new interest rate mortality table assumptions, in April of 1998. The regulations provide specific guidance on how the interest rate provisions are to be implemented. In contrast, for the applicable mortality table, the regulations provide only that the table is to be "prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin." Treas. Reg. Section 1.417(e)–I(d)(2). Treasury's approach of publishing the table required by the statute in a revenue ruling, instead of in the regulations, effectively precluded needed public comment on the 50/50 mandatory gender split that would have otherwise been required under the Administrative Procedures Act.

The adverse impact of the regulations will be felt particularly in industries where plans are collectively bargained. These plans, presumably for historical reasons, cover work forces that are frequently heavily skewed by gender. Collectively bargained workforces that are dominated by females include flight attendants and skilled nurses. Conversely, such workforces dominated by males consist of, for example, heavy construction, road building, pilots, long-haul trucking, movers of household goods, oil and gas, mining, and forestry workers. Accordingly, this arbitrary regulatory fiat will work to *overfund* pensions in industries where rates of female plan participation are particularly high and will work to *underfund* pensions where rates of male participation are high.

Rev. Rul. 95–6 hardly levels the playing field between annuities and lump sums. Male employees in male-dominated plan populations will be strongly encouraged to take their benefits in a lump sum in order to take advantage of the windfall, possibly exposing their retirement security to the increased risk of dissipation of their retirement "nest egg." Female employees in female dominated plans will receive less than they would if the plan assumptions reflected reality of workforce participation by gender.

Effect of a 50/50 Mortality Table

The Service's 50/50-gender blend table has an unintended and inequitable effect on the level of funding and on the calculation of the present value of lump sum payments. As previously discussed, the primary focus of GATT was on reducing underfunding of pension plans. Accordingly, GATT's applicable mortality table was designed to prevent plan sponsors from making assumptions that placed plans at risk by minimized funding obligations. The 50/50 mortality table assumptions negate that goal by reducing a plan's ability to provide an accurate and adequate funding level. The 50/50 assumption, which can be objectively inaccurate, requires plan administrators to calculate actuarially inaccurate present values of lump sum payments, at least where plan population by gender is unbalanced.

For example, if an individual would receive a $1,000 lump sum payment at retirement based on GAM 83 using gender specific mortality, the following table presents the adjusted lump sum amount that would be paid to that individual using the 50/50 blended table:

Effect of Blended Mortality—Table on Gender Specific Lump Sum of $1,000

[Discount Rate: 7.0 percent]

Age	Male	Female
55	$1,042	$955
60	$1,053	$944
65	$1,068	$929

This table shows that an age 60 male retiree receives a $53 windfall under the 50/50-blended table and an age 60 female retiree receives a $56 shortfall.

Proposed Amendment

Congress should rectify this inaccurate treatment by amending the Code to include a rule addressing use of the required mortality table for those plans which contain a lump sum distribution option and which cover populations that are primarily male or primarily female. For example, the Code could be amended to include a proposal that would provide an alternative rule for determining the present value of a permitted lump sum payment if 80 percent or more of a plan's covered participant population is comprised of a single gender. In such cases, the plan would be permitted an election to utilize Treasury's applicable mortality table with the assumption that the dominant gender comprises 80 percent, and the minority gender comprises 20 percent, of the plan's covered participant population. In order to keep the proposal simple, the rule could provide that, if in any subsequent plan year the plan did not satisfy the 80 percent test then, in that and all successive plan years, the plan sponsor could not make such an election.

Statement of Dianne Bennett, President, Hodgson, Russ, Andrews, Woods and Goodyear, LLP, Buffalo, NY

My name is Dianne Bennett. I am President of Hodgson, Russ, Andrews, Woods & Goodyear, LLP, a 170-lawyer law firm headquartered in Buffalo, New York. I am writing on my own behalf and not on behalf of any of my colleagues or clients. I have been involved with tax policy since 1975. I am the principal editor and creator of a book edited by me with 5 of my colleagues, *Taxation of Distributions from*

Qualified Plans, published by Warren Gorham & Lamont, and the author of several articles, including a seminal article on simplification of distributions entitled "Simplifying Plan Distributions," published in the January 18, 1998, issue of Tax Notes. My law firm represents hundreds of employers for employee benefit purposes, most of them considered small by the demographic standards of the Congress, most of them covering fewer than 1,000 participants and the greater majority covering fewer than 100 participants. Hodgson Russ also is unusual in that it administers "small" defined contribution plans. Therefore, I have extensive experience in the areas addressed by the Subcommittee.

My comments in this statement address H.R. 1102, the "Portman-Cardin Bill," the "Comprehensive Retirement Security and Pension Reform Act of 1999."

Portman-Cardin has laudable goals, "to give all Americans the opportunity to better prepare for retirement, to provide meaningful savings opportunities for employers of small business, and to enhance retirement security of women, the disabled and families," among others. In spite of the laudable goals, I am convinced that most of the significant provisions of the Portman-Cardin Bill in fact will have the opposite effect. The most significant provisions of Portman-Cardin will shift tax benefits to higher-income taxpayers. Virtually every significant provision is designed to grant tax benefits to participants in plans who earn more than $100,000 annually. The likely result is to shift of the tax burden from higher-income taxpayers to lower-income taxpayers and to take benefits *away* from middle- and lower-income taxpayers. I believe it likely that the effect of Portman-Cardin, were it to pass, would be to expand retirement plans that benefit *only* owners of businesses and to reduce dramatically the benefits granted to non-owner employees in small business plans.

The specific provisions that are most likely to produce this adverse effect on retirement income for middle-and lower-class taxpayers are (1) the increase in compensation counted for retirement plan purposes from $160,000 to $235,000, (2) the increase in the maximum annual employee salary reduction contributions to a § 401(k) plan from $10,000 to $15,000, (3) the increase in the maximum permitted contributions to a defined contribution plan from $30,000 to $45,000, (4) the expansion of the SIMPLE plan to pure salary reduction, with increased limits, and (5) the return to facts and circumstances non-discrimination testing.

THREE SAMPLE PLANS

I selected at random 3 of the plans we administer, representing very different sectors: health (a medical group of more than 60 participants), manufacturing (the non-union segment of more than 80 participants), and a distribution company with 20 participants.

In the case of the 60+ participant medical group, the only persons in 1998 contributing at the $10,000 limit were 4 doctors earning more than $100,000 per year. Eight other participants contributed over $5,000 and 5 of those earned over $100,000 per year. It is clear to me that an increase in the amount of compensation that can be counted, the $10,000 § 401(k) limit, and the § 415 maximums will result in the doctors contributing more to their plan, but no one else doing so. In addition, it is likely that the plan will be redesigned so that the doctors can continue to achieve their higher maximum contributions, while a smaller percentage of compensation and smaller dollar benefits are contributed for everyone else. This is achieved by the increase in the maximum compensation to $235,000, the increase in the $30,000 limit to $45,000, the applicability of a facts and circumstances tests, and the interplay of all of these with cross-testing.

With respect to the 80+ participant manufacturing company plan, of the 8 persons contributing at the maximum in 1998, 3 are the business owners each earning more than $100,000 per year, 3 of the remaining 5 earn over $80,000. The lowest salaried person who contributed the maximum earns over $65,000. If the limits are increased, the owners clearly will contribute more, and the amounts contributed for the other participants will be less.

The third plan with 20 participants had only 1 participant contributing at the maximum. He is the owner and CEO and earns over $100,000. The only other person contributing over $3,500 in this plan earned over $60,000.

The conclusion one must draw from these representative samples is that the higher-income taxpayer generally will be the ones who benefit from Portman-Cardin. The tax benefits will be provided primarily to people earning more than $100,000 annually. And do not be misled: benefits *will* be taken away from other participants. These results are in direct contradiction to the stated goals of Portman-Cardin.

EFFECT ON SIMPLE CHANGES

The SIMPLE plans have not been attractive to our clients, because of the required contributions. By removing the required contributions and permitting a salary-reduction-only SIMPLE plan, with higher limits, some of the smaller employers will shift to SIMPLE plans for the owners to contribute their $15,000, and with no employer contributions. Again, the goals of Portman-Cardin will be vitiated.

EFFECT ON WOMEN

The statement that these changes will enhance retirement security of women also is not correct, based on my experience. The only provision that might benefit women as a class is the required accelerated vesting in matching contributions. Although most of my clients would disagree with the positions I take in this statement (because they are business owners and they do not want to be told how much to contribute for their employees), they certainly will oppose this provision. The idea that individuals can "catch up" on contributions also will benefit primarily higher-income taxpayers. As you can see from the examples I cited above, middle-and lower-income taxpayers do not make enough money to contribute $15,000 of their own money per year, much less $20,000. People making $30-$40,000 cannot contribute $20,000, unless they are second earners in a very high income family. It is untenable, in my view, to say that this provision will benefit women.

ROTH 401(K)

I also am compelled to comment on the notion of after-tax "qualified plus" 401(k) contributions. The Roth IRA already is considered by virtually every tax policy expert to be a tax policy stood on its head. It is a complete shift of tax benefits to higher-income taxpayers, providing tax benefits they do not need to save money they would already save. My clients who have established Roth IRAs are semi-retired wealthy people who can manage to control their income in a particular year, and the children and grandchildren of wealthy taxpayers whose parents and grandparents establish Roth IRAs for them. Yes, I give my adult children Roth IRAs in their Christmas stockings; frankly, we all smile over the abusive tax benefits that are shifted towards us and away from those who truly need incentives to save. Providing "qualified plus" contributions in 401(k) plans exacerbates the shifting of tax benefits to higher-income taxpayers, helps the wealthy have more money for their children to inherit, and undermines the qualified plan system. Furthermore, the Roth 401(k), like the Roth IRA, is a lesson in complexity, rather than simplification.

IRA EXPANSION

The expansion of IRAs to $5,000 also threatens to close many small business retirement plans. If a small business owner can contribute $5,000 for himself or herself to an IRA, why should the owner establish a qualified plan and contribute for others? Many middle-and lower-income employees do not value, dollar for dollar, contributions to retirement plans. To remain competitive in the workplace, many employers prefer to give these employees their wages directly in cash. If the goal of Congress is to promote retirement savings by those who otherwise might not save, it is doing the opposite by increasing the IRA limits and diverting funds away from qualified plans.

RED-TAPE OR NOT

There are other provisions in Portman-Cardin that purport to provide opportunity for employees of small business. Among these is elimination of IRS user fees for small business plans. In fact, again, I know of no clients who have failed to establish plans because of IRS user fees. The user fees are small enough for various prototype plans, as low as $125, that virtually no business owner fails to establish a plan because of IRS user fees. Again, the emphasis is in the wrong place. It is not the "red tape" of a user fee that precludes small business owners from establishing qualified plans. It is the marketplace that forces them to pay their employees as much cash as possible. Just like the other provisions of Portman-Cardin, this one will have virtually no effect on the small business owner.

SIMPLIFICATION

There are a few provisions in Portman-Cardin that make sense from my experience. These include repeal of the rule that limits the availability of plan loans for self-employed persons, the repeal of the "same desk" rule and the increase in portability. But, extending the 60-day deadline for "hardship" is a complication.

Portman-Cardin purports to aim for simplification, but, like all other Congressional encroachments into the pension law, it does not. Dictating to the IRS the nitty-gritty of the minimum distribution rules does not simplify. Adding an extension of the 60-day rollover deadline for "hardship" situations does not simplify anything. There are myriad bills introduced each year by well-meaning representatives to add exceptions to the 10% additional income tax on early distributions; most are applicable only to IRAs and not qualified plan distributions. Again, although the individual goal may seem worthy, the result is a morass of laws that are difficult to enforce and create enormous complexity. Studies have shown, as well, that the 10% tax is not a deterrent to those who need the funds for any reason.[1] So if people need the funds, let them take it out with the 10% tax. But stop creating exceptions—and exceptions to exceptions. These are exactly the types of provisions that preclude portability as well, because they differentiate among distributions from different types of plans.

My suggestion is that Congress give the IRS leeway to develop reasonable rules. Congress can set some parameters. But it should not try to write regulations into statutes. It could repeal some of the specifics now inherent in the minimum distribution rules—without stating exactly what the replacement rules should be. Again, give the IRS leeway and the direction to simplify these rules.

The repeal of the so-called "multiple-use test" also will benefit higher-income taxpayers at the expense of lower-income taxpayers. Our experience with the plans we administer indicates that at least 75% of the § 401(k) plans see the salary reduction contributions of higher-income participants reduced because of the multiple-use test. Repeal of the test simply allows more discrimination against lower-income participants. Repeal of the test hardly can be classified a simplification. All plans now have their administration set up on computers and run these numbers as a matter of course. The programs are there; to have the computer spit out one more test is not a complexity.

Facts and Circumstances Testing

The return to facts and circumstances testing proposed in Portman-Cardin is disturbing. The IRS cannot handle the burden of evaluating every nondiscrimination test through what we used to refer to as the "smell test." And, although reversion to old law may seem like a simplification, in fact, it is a complication. It also will result in game-playing by employers who want to deny appropriate benefits to participants in plans. Employers have learned to live with the "bright line" tests and wish in many ways simply to be left alone. Congress needs to address complexity and simplification. But it needs to do so forthrightly.

Better Benefits

These are a few provisions of Portman-Cardin that my experience tells me will result in better benefits for "workers," as the bill purports to do. One of these is the proposal to permit 25% of total participant compensation to be made as a deductible contribution to any type of defined contribution plan, rather than the current 15% limit that is applicable to profit sharing plans. Generally, this change would permit employers to maintain 1 plan, instead of a combined profit sharing and money purchase pension plan. Although one can argue that a money purchase pension plan provides more security, in some cases employers simply are not offering more than the 15% limit when they would do so, if permitted, under one plan. Of course, if the dollar limitations are increased so that compensation is counted in excess of $160,000, it is not clear that any employer would set up a plan that resulted in more than 15% of compensation being contributed. In fact, likely some of the paired money purchase pension plans would be terminated.

Conclusion

The language promoting Portman-Cardin offers the *opposite* of what the provisions will effect. Congress needs to take a long, hard look at the types of provisions it has put in effect to date in the pension area and the types it is considering in this legislation. It owes it to the American people to stop the constant changes in the pension law to the point where the complexity is overwhelming (such as the numerous bills referenced above that would add exceptions to the 10% additional tax

[1] Chang, "Tax Policy, Lump-Sum Pension Distributions, and Household Saving," 49 Nat'l Tax J. 235 (June 1996).

on early distributions), and not to expand limits on benefits under the guise of providing benefits to working people who currently have little or no benefits. Almost every provision of Portman-Cardin will benefit those who already save sufficiently for retirement, and likely will lead to the reduction of benefits for many of the rest.

[By permission of the Chairman]

Statement of Central American and Caribbean Textiles and Apparel Council, San Salvador, El Salvador

This statement is submitted by the Central American and Caribbean Textiles and Apparel Council (CACTAC), a Regional interest group representing the textiles and apparel industry of all CBI countries. Its purpose is to advance this important labor intensive sector to become fully competitive in the global economy, to improve its contribution to the economic and social development of the Region and to enhance trade relations with important partners like the United States. CACTAC members generate over 400,000 direct jobs and exports of apparel goods to the U.S. are close to U.S. $8.2 Billion Dollars, in 1998.

Passage of this legislation, H.R. 984 is paramount to maintain stability and security in the Region. Given the degree of manufacturing integration in 807 and 807–A (production sharing), U.S. imports from the CBI contain over 80% U.S. value. This means, U.S. in.dustry, services and labor share the highest percentage value of trade and production from CBI apparel goods imports. In Dollar per Dollar relationship the United States clearly is the main beneficiary. However in overall terms the Region greatly benefits, so at the end we have a win-win relationship.

This production sharing U.S. CBI integration is the natural stategic alliance needed, to successfully compete with China after the year 2005, when all quotas should be terminated according to WTO Agreement on Textiles and Clothing, ATC. For this reason, CACTAC believes that, the sooner U.S.–CBI negotiate a comprehensive free trade agreement, FTA, the sooner we should be ready to take up the challenge with a fair chance of success.

H.R. 984 contains the basic NAFTA provisions that would meaningfully enhance the Caribbean Basin Economic Recovery Act I and II, since it would grant equivalent tariff and quota treatment during the transition period to CBI originating goods equal to the NAFTA treatment. As you know this provision would permit that not only U.S. yarn forward apparel goods to receive a preference but also those made with CBI regional fabric. This is a very important development element since the Region can not remain only a basket for just sewing operations, CBI should rather be the U.S. equal partner in this business.

As you know, through the nineties, the CBI Region has been one of the most dynamic growing exporters in the World, showing a 26% percent market share growth for the period 93–97 or a healthy 6.5% average annual growth, however it falls down from 97 to 98, actually losing market share in 3.05%.

This down ward trend also shows up in terms of U.S. imports by Dollar value, 1998 experiences the lowest growth rate in record, as a matter of fact, for the fist time the CBI Region is growing at a slower pace than the World, 9.04% for CBI, versus 12.49% for the World growth, see exhibits A and B.

Devastation caused by George and Mitch last year, the slow recovery of the Asian crisis and a crawling South American financial crisis, are causing deep concern in the Region, that this trend may continue through 1999. Should this be the case Mr. Chairman the CBI countries may badly fall behind in providing employment for our people, risking lowering key social devolopment indicators in the entire Region, followed by social unrest and instability in many of our young democracies.

Mr. Chairman, CACTAC shares your unshakable tenacity to defend U.S. free trade with the Region, particularly your view and intent; Sec. 102 POLICY, "to seek accession of CBI countries to the NAFTA or a free trade agreement comparable to the NAFTA at the earliest possible date, with the goal of achieving full participation in the NAFTA or in a free trade agreement comparable to the NAFTA by all partnership countries not latter than January 1, 2005." We also feel CCARES is the intermediate step we need to avoid standing still and keep the momentum going towards the Free Trade Agreement.

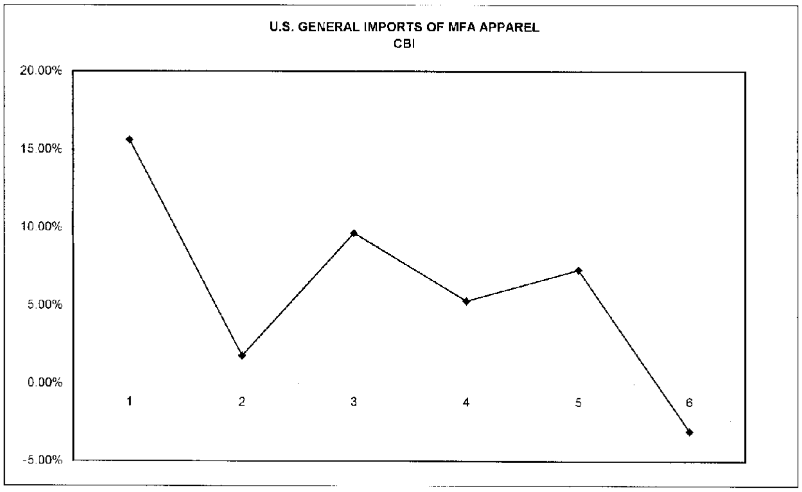
Finally Mr. Chairman, a meaningful CBI Bill has been anxiously awaited for the last six years, unfortunately experiencing many frustrations on the way. This time with your unswerving resolve we are sure H.R. 984 will succeed in passing quickly full Committee and finally merge with the Senate Bill in Conference. At such point we must make sure the final legislation does carry the provisions you have intended in this bill.

Thank you for the opportunity to present our views on the subject.

U.S. GENERAL IMPORTS OF MFA APPAREL
CBI

MARKET SHARE OF TOTAL

	1993	% Change	1994	% Change	1995	% Change	1996	% Change	1997	% Change	1998	% Change
CBI	14.05	15.63%	14.3	1.78%	15.68	9.65%	16.51	5.29%	17.71	7.27%	17.17	-3.05%

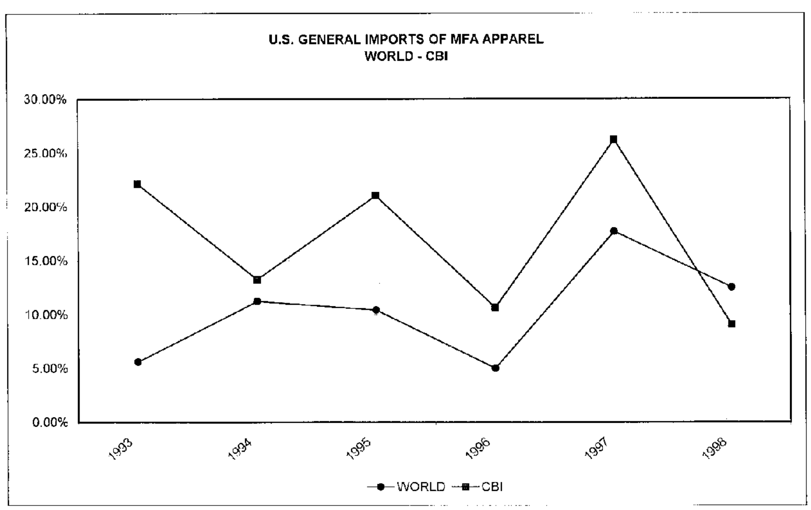


Data - International Development Systems, Inc.

Exhibit B

U.S. GENERAL IMPORTS OF MFA APPAREL
WORLD - CBI
Calendar Year 1993 - 1998
(U.S. Dollar Value)

	1993	1994	1995	1996	1997	1998
WORLD	5.62%	11.24%	10.39%	5.02%	17.69%	12.49%
CBI	22.14%	13.25%	21.01%	10.62%	26.21%	9.04%



Data - International Development System, Inc

Statement of Paul Yakoboski, Senior Research Associate, Employee Benefit Research Institute

The voluntary employment-based retirement system has been a success for American workers at large employers: 85 percent of workers at employers with 100 or more employees are covered by a retirement plan. Two-thirds of workers at large employers actually participate in a defined contribution plan at work.

However, the same cannot be said of workers at small enterprises. At very small employers (those with under 25 employees), 20 percent of workers are covered by a retirement plan, and at employers with 25–99 employees, 50 percent of workers are covered by a plan. At very small employers (those with under 25 employees), only 15 percent of workers actually participate in a defined contribution plan, and at employers with 25–99 employees, 36 percent of workers are plan participants.

Why don't more small employers sponsor retirement plans? In 1998, the Small Employer Retirement Survey (SERS) examined small employers (100 or fewer employees) and retirement plan sponsorship.[1] SERS identified three main reasons small employers do not offer a retirement plan:

- The first reason, which is a largely ignored but important fact, is what small employers see as their workers' preference for wages and/or other benefits: 22 percent of small employers cited this as the most important reason why they did not offer a retirement plan.
- The second main reason cited by small employers for not offering a plan is administrative costs. Fourteen percent cited cost of plan set-up and administration as the most important reason for not offering a plan, and an additional 4 percent cited too many government regulations as the most important reason for not offering a plan.
- The third main reason is uncertain revenue, making it difficult to commit to a plan. Sixteen percent cited this as the most important reason for not offering a plan.

So, while administrative issues matter, the point we need to emphasize is that other factors are also at work that need to be taken in account when discussing policy options.

In addition, it appears that there is a fair amount of misunderstanding about retirement plans among small employers who do not sponsor one, especially regarding costs. For example, the survey found that one-third of small employers without a plan don't know that a plan can be set up for less than $2,000, and many think they are legally required to match all employee 401(k) contributions. In fact, sponsoring a plan does not have to be as expensive and administratively burdensome as many employers apparently believe.

There are reasons to be optimistic about the prospects for increased plan sponsorship among small employers:

- Sixty-eight percent of those without a plan do not think their employees are well prepared for retirement.
- One-half of those without a plan have seriously considered it in the past.
- Seventeen percent say they are very likely, and 27 percent somewhat likely, to start a plan in the next two years.

The findings indicate that if significant progress is to be made in retirement-plan sponsorship among small employers, we must address employer concerns about offering plans and better educate them as to the options that are available to them and what these options actually entail. However, the findings also show that effective policy must also help make retirement planning and saving a priority for the workers in small businesses as well.

Plan Evolution and Its Implications

Individuals today have greater opportunities to plan and save for retirement than members of any previous generation. It can be argued that retirement plans today match the reality of the work experience for most Americans better than at any time in history. The "lifetime job" has never existed for most workers.[2] Over recent years (1983–1998), median tenure among male workers has dropped noticeably, but this decrease was concentrated among prime-age male workers (chart 1). Despite this decline, tenure in 1998 was comparable with that of decades past. Tenure levels for female workers have risen consistently over time (chart 2). The fact is that there has always been a good deal of "job churning" in the U.S. economy. Retirement plan design and public policy have evolved over time, and this evolution means that plans are better suited to meet the needs of mobile workers.

Vesting requirements were instituted with the Employee Retirement Income Security Act of 1974 (ERISA) and have become more stringent over time.[3] The Revenue Act of 1978 codified 401(k) cash or deferred arrangements into law. The defined contribution plan market has experienced dramatic growth over time, spearheaded by 401(k) plans.[4] Such plans are offered as complements to defined benefit plans among large plan sponsors and as primary retirement vehicles among smaller companies and those just instituting a plan.[5] Benefit portability upon job change (being able to take the retirement assets when leaving a job) and the potential for workers to fully preserve benefits are key features of defined contribution plans. Hybrid plans have emerged combining features of defined benefit and defined contribution plans, including the portability features of defined contribution plans.[6]

But it is also obvious that workers today face far greater individual responsibilities and very explicit decision-making requirements that will directly affect their retirement income security. So while the vehicles for retirement income security are there, the question remains as to whether workers are taking full advantage of the opportunities afforded them. In many instances, unfortunately, the answer is "no." To begin with, one-third of workers are not saving for retirement.

Among those saving, other concerns arise—such as whether contribution levels are adequate and whether the money is being invested wisely. For example, whether workers will accumulate adequate assets in their 401(k) plans to help fund their retirement will depend in part on the amount they contribute and how those funds are invested. EBRI analysis has provided stark evidence of the effect that plan features and legal limits can have on workers' decisions about contribution levels. On the investment side, a real dichotomy exists in allocation behavior among workers within similar demographic groups: A significant fraction of participants, particularly younger ones, are heavily invested in equities, while at the same time a large percentage of their peers hold no equities at all in their accounts.

Another major concern is whether retirement assets are actually preserved until retirement occurs. Research indicates that the level of retirement benefit preservation is low among many segments of the working population, despite the fact that preservation rates have been increasing over time. Many workers, especially younger ones, "cash-out" and spend their retirement assets when they leave a job, rather than rolling the assets over into another retirement account.

CONTRIBUTION LEVELS IN 401(K) PLANS

EBRI has analyzed the contribution levels in three large 401(k) plans that had approximately 200,000 participants combined. These plans were sponsored by IBM, AT&T, and New York Life for their employees, and all have employer matching provisions to encourage employees to participate and contribute. There are constraints placed on employees' maximum contribution levels, set by both the specific plan and federal law. These plans also have well-developed educational programs designed to assist workers in making appropriate decisions regarding their participation in a 401(k) plan.

The findings provide clear evidence of the effect that plan features and legal limits can have upon workers decisions of level of contribution to a plan.[7]

- The most striking result is that 30 percent or more of the participants analyzed have their contribution rate directly affected by plan design.
- Findings indicate that older workers tend to have their contributions constrained by maximum limits (plan or legal), probably because they tend to be more focused on retirement and thus more likely to contribute at higher levels. Many younger workers recognize the value of the employer match, contributing just enough to take full advantage of that plan feature—but no more.
- Plan features also appear to interact with worker earnings in determining contribution rates. Lower-earning participants are more likely to contribute the maximum amount that is matched, taking advantage of all the "free" employer money that is available. Higher-earners are more likely to contribute the maximum amount allowed by the plan or the tax code.
- Employer attention is often focused on the issue of getting workers to participate in 401(k) plans at levels that will lead to an adequate retirement income. Such participation is also needed to pass Internal Revenue Code discrimination testing. These findings would indicate that one way to boost worker contribution rates in a plan would be to increase the percentage of salary upon which matching contributions are made.
- The 402(g) limit imposed by law is a binding constraint for some workers, and effectively restrains the amount of earnings they are able to save for retirement on a tax-deferred basis. It is older, higher-earning participants who are most often constrained by this limit. However, it is precisely at this point in a career, i.e., when

one is older and earning levels have risen, that many workers start devoting serious attention to planning and saving for retirement.

ASSET ALLOCATION IN 401(K) PLANS

The Employee Benefit Research Institute (EBRI) and the Investment Company Institute (ICI) have been collaborating over the past two years in the collection of data on participants in 401(k) plans. In this collaborative effort, known as the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project, EBRI and the ICI have obtained data for 401(k) plan participants from some of their sponsors and members serving as plan recordkeepers and administrators. The data include demographic information, annual contributions, plan balances, asset allocation and loans. In 1996, the first year for which data are available for analysis, the EBRI/ICI database appears to be broadly representative of the universe of 401(k) plans. The data include information on 6.6 million active participants in 27,762 plans holding nearly $246 billion in assets. Furthermore, it is by far the most comprehensive source of information on individual plan participants.

The principal findings regarding asset allocation are:[8]

- For all participants, 44.0 percent of the total plan balance is invested in equity funds, 19.1 percent in employer stock, 15.1 percent in guaranteed investment contracts (GICs), 7.8 percent in balanced funds, 6.8 percent in bond funds, 5.4 percent in money funds, 0.8 percent in other stable value funds, and 1.0 percent in other or unidentified investments. This allocation implies that over two-thirds of plan balances are invested directly or indirectly in equity securities.
- Asset allocation varies with age. Younger participants tend to be more concentrated in stock-related investments, whereas older participants are more heavily invested in fixed-income assets. For example, the average share held in stocks through equity funds, company stock, and balanced funds declines from 76.8 percent for participants in their twenties to 53.2 percent for participants in their sixties. In contrast, fixed-income investments rise from 22.1 percent for participants in their twenties to 45.9 percent for participants in their sixties. More specifically, younger participants hold more of their account balances in equity funds than older participants, who tend to invest more heavily in GICs and bond funds. The trend is less true for employer stock.
- Investment options offered by 401(k) plans appear to influence asset allocation. Plans offering only the options of equity, bond, balanced, and money funds tend to have the highest allocations in equity funds. The addition of company stock to these options substantially reduces the allocation to equity funds. The addition of GICs to the four options lowers allocations to all other investment options, with the greatest effect on bond and money funds.
- Employer contributions in the form of company stock affect participant allocation behavior. Participants in plans in which employer contributions are made in company stock appear to decrease allocations to equity funds and to increase the allocation of company stock in self-directed balances. In these plans, the average concentration in company stock from both employer-directed and participant-directed investments combined exceeds fifty percent of total plan balances for all age groups younger than 60.
- The allocation of plan balances to equity funds varies from participant to participant. For example, 24.5 percent of the participants have over 80 percent of the plan balances invested in equity funds, whereas 6.9 percent have less than 20 percent allocated to equity funds and 30.6 percent hold no equity funds at all. However, of those with no investments in equity funds, more than one-half hold either employer stock or balanced funds. As a result, overall equity-related investments of those holding no equity funds is 38.5 percent of plan balances.

BENEFIT PRESERVATION UPON JOB CHANGE

This section discusses analysis of data provided by Hewitt Associates regarding lump-sum distributions and benefit preservation. The 1996 Hewitt database used for this particular analysis consists of 87,318 distributions, totaling $2.3 billion. Out of this total, 71,736 distributions went to workers on job termination (i.e., to job changers), and these distributions totaled $1.3 billion. The 1993 data consist of 138,088 distributions, totaling $2.4 billion. Out of this total, 117,781 distributions were made to workers on job termination (i.e., to job changers), totaling $1.6 billion.

Key results include:[9]

- Forty percent of distributions to job changers in 1996 were rolled over into another retirement plan, up from 35 percent in 1993. Rollover percentages are higher when examined by the dollars distributed reflecting the fact that larger distributions are more likely to be preserved. Seventy-nine percent of all dollars distributed in 1996 were rolled over, compared with 73 percent in 1993.

• In 1996, 20 percent of distributions of less than $3,500 were rolled over compared with 95 percent of distributions larger than $100,000. Analogous findings emerge when the analysis focuses on the dollars distributed; among distributions less than $3,500, 27 percent of the dollars were rolled over while among distributions greater than $100,000, 96 percent of the dollars were rolled over. The likelihood of rollover is also positively correlated with recipient age.

• From a retirement income security perspective, there is good news in these data. The propensity to rollover has been increasing and over three-quarters of the dollars distributed are preserved via rollover.

• At the same time, the data indicates areas of shortfall. Most distributions do not result in a rollover; 60 percent resulted in a cashout. It can be argued from a financial planning perspective that even relatively small sums of money can compound into nontrivial contributions to a retirement nestegg over a period of decades. Furthermore, the importance of preservation of seemingly small balances is enhanced by the fact that individuals may receive a number of these "small" distributions over the course of a career.

THE CHALLENGE

There are no quick fixes or "silver bullets" that will ensure retirement income security for today's workers. It can be argued that the voluntary employment-based retirement system has been a success at large employers, where 85 percent of workers have an employer that sponsors a plan, and 66 percent of workers actually participate in a plan. The same cannot be said at the small employer level, where 29 percent of workers have an employer that sponsors a plan and 21 percent of workers actually participate in a plan.

Our research indicates that long-term policies aimed at improving workers' retirement income security must not only address employers' concerns about offering plans but also must educate individual workers about the need to make retirement saving and planning a priority.

ENDNOTES

[1] For a complete discussion, see Paul Yakoboski and Pamela Ostuw, "Small Employers and the Challenge of Sponsoring a Retirement Plan: Results of the 1988 Small Employer Retirement Survey," EBRI Issue Brief no. 202 (Employee Benefit Research Institute, October 1998).

[2] For a complete discussion, see Paul Yakoboski, "Male and Female Tenure Continues to Move in Opposite Directions," EBRI Notes, vol. 20. no. 2 (Employee Benefit Research Institute, February 1999).

[3] Prior to the passage of ERISA, there were no federal regulations relating specifically to vesting. ERISA established three standards that effectively required plans either to fully vest participants after 10 years of service or to partially vest participants prior to 10 years of service with full vesting occurring after no more than 15 years. These vesting requirements have become stricter with legislative changes over time. Current law requires a plan to adopt vesting standards for the employee's benefit (the balance under a defined contribution plan or the accrued benefit under a defined benefit plan) at least as liberal as one of the following two schedules: full vesting (100 percent) after five years of service (with no vesting prior to that time, known as cliff vesting), or graded (gradual) vesting of 20 percent after three years of service and an additional 20 percent after each subsequent year of service until 100 percent vesting is reached at the end of seven years of service. Benefits attributable to employee contributions to either defined contribution or defined benefit plans and investment income earned on employee contributions to defined contribution plans are immediately vested. Vesting rates (the fraction of plan participants who are vested) have been rising steadily over time. In 1965, 12 percent of plan participants were vested. In 1975, the year after ERISA was passed, 44 percent of plan participants were vested. As of 1993, 86 percent of plan participants were vested, an increase of 95 percent since the passage of ERISA. This increase can be attributed to both the maturation of the employment-based retirement plan system and stricter vesting requirements that have been legislated over time.

[4] The number and percentage of individuals participating in private defined contribution plans is increasing relative to the number and percentage participating in defined benefit plans. The total number of participants in all defined benefit plans was 33 million in 1975. Participation increased to 40 million in 1983, and has remained in the 39 million–41 million range since that time. The total number of par-

ticipants in defined contribution plans increased from 12 million in 1975 to 45 million in 1994.

[5] Despite the many changes in government regulation regarding defined benefit plans and the increased prevalence of defined contribution plans, defined benefit plans are still an important part of both the private and public retirement systems. The data show that they are firmly entrenched in large companies and in plans covered by collective bargaining agreements. It is unlikely that many of these plans will be shifted—at least completely—to defined contribution plans.

[6] For a complete examination of the trends in the number of defined benefit plans and defined contribution plans and the implications of these trends, see Kelly Olsen and Jack VanDerhei, "Defined Contribution Plan Dominance Grows Across Sectors and Employer Sizes, While Mega Defined Benefit Plans Remain Strong: Where We Are and Where We Are Going," EBRI Issue Brief no. 190/EBRI Special Report SR–33 (Employee Benefit Research Institute, October 1997). For a complete discussion of hybrid plans, see Sharon Campbell, "Hybrid Plans: The Retirement Income System Continues to Evolve," EBRI Issue Brief no. 171/EBRI Special Report SR–32 (Employee Benefit Research Institute, March 1996).

[7] For a complete discussion, see Paul Yakoboski and Jack VanDerhei, "Contribution Rates and Plan Features: An Analysis of Large 401(k) Plan Data," EBRI Issue Brief no. 174 (Employee Benefit Research Institute, June 1996).

[8] For a complete discussion, see Jack VanDerhei, Russell Galer, Carol Quick, and John Rea, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity," EBRI Issue Brief no. 205 (Employee Benefit Research Institute, January 1999).

[9] For a complete discussion, see Paul Yakoboski, "Large Plan Lump-Sums: Rollovers and Cashouts," EBRI Issue Brief no. 188 (Employee Benefit Research Institute, August 1997).

Chart 1
Prime Age Male Tenure Trends, by Worker Age, 1951-1998

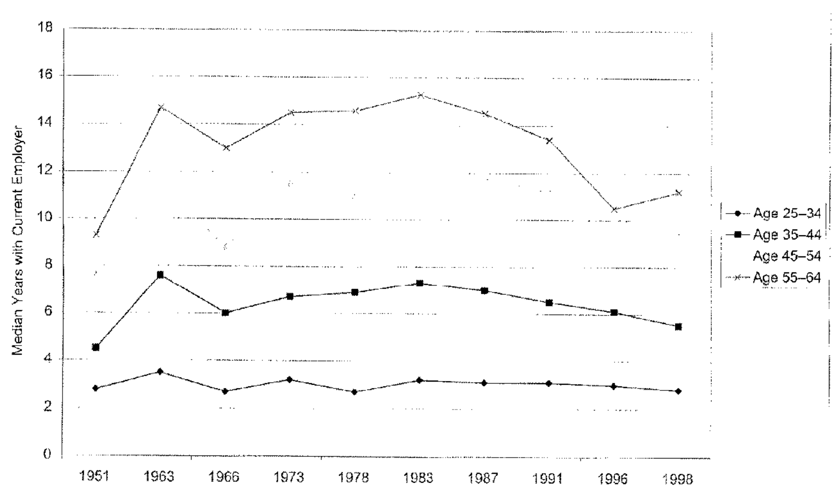
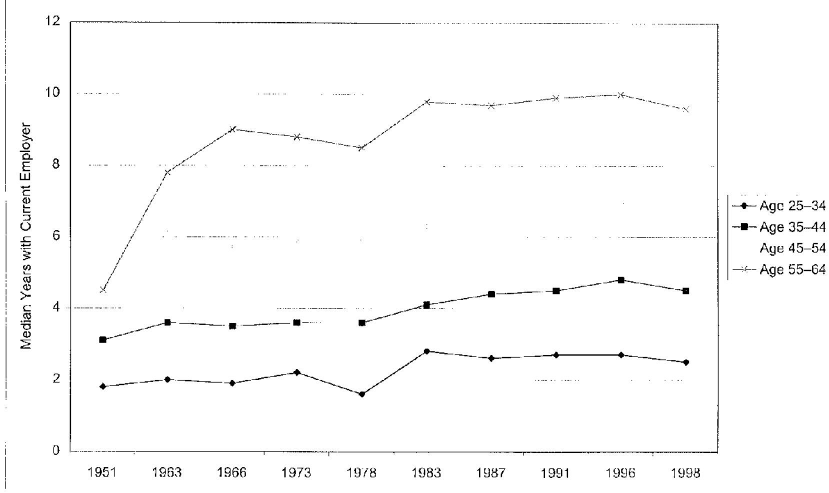


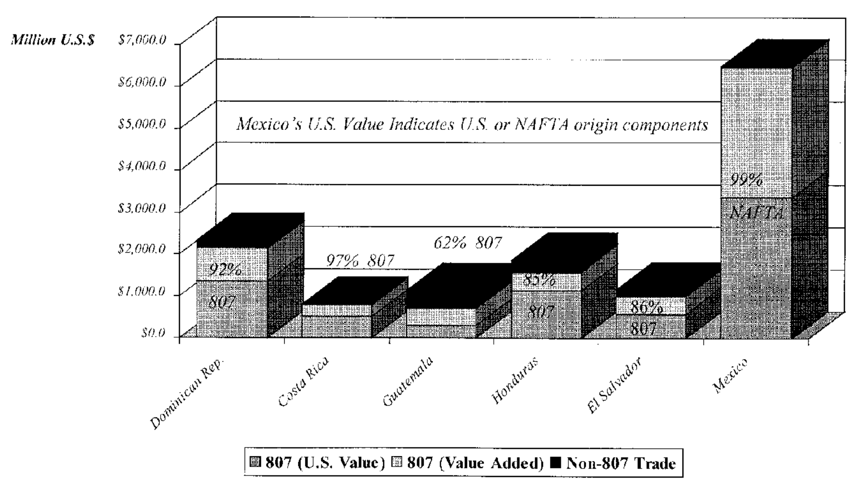
Chart 2

Prime Age Female Tenure Trends, by Worker Age, 1951-1998



807 Program or NAFTA (Mexico)

as % of Total Apparel Shipped to the U.S.



Statement of Michael Keeling, President, ESOP Association

Chairman Houghton, and Members of the Oversight Subcommittee, I am Michael Keeling, President of The ESOP Association, a national trade association based in Washington, D.C., with over 2,100 members nationwide, two-thirds of which are corporate sponsors of Employee Stock Ownership Plans, or ESOPs, and other members are either providing services to ESOP company sponsors, considering installing an ESOP, or affiliated with an educational, or non-profit institution.

A little indulgence before turning to the substance of The ESOP Association's statement for your "pension hearings," as announced in Committee Press Release OV–4. You may not realize this fact, but the Oversight Subcommittee has a strong tradition of reviewing ESOP and employee ownership issues as part of its lead role in Ways and Means in handling ERISA issues. By my count, this is the fifth time I have or submitted a statement pertaining to ESOPs to this Subcommittee.

May I state that it is very pleasing to the employee ownership community to know that the Subcommittee, through its leadership continues its interest in ESOPs and employee ownership, as it did under your predecessor Congresswoman Johnson and her predecessor, former Congressman J. J. Pickle of Texas.

Again, I appreciate your indulgence in my making these observations.

We come today because the press release announcing today's hearings quoted Chair Houghton saying, "The objective (of the hearings) is to make a good pension system even better...." The release said the subcommittee, in particular, wanted to "explore ways to remove burdensome regulatory requirements."

We have need this call, and present for your consideration an idea to clarify a law pertaining to deductible dividends paid on ESOP stock.

The treatment of reinvested Employee Stock Ownership Plan, or ESOP, dividends, is addressed in several bills introduced in the House, including both the 105th and 106th Congress's Portman-Cardin bills, H.R. 3788 and H.R. 1102 respectfully, and in the 105th Congress H.R. 1592, introduced by Congressman Ballenger, the House Education and the Workplace Committee. Original co-sponsors included your colleagues Congressmen Weller and Neal. Congressman Ballenger plans to reintroduce a 1999 version of H.R. 1592 soon.

So the questions are, "What is this provision for which we seek attention, and how would it make our system better, and remove regulatory burdens....?"

The ESOP Association strongly believes that the answer to these questions will persuade this Subcommittee to recommend to the full Committee that any tax bill addressing pension issues include the ESOP dividend deduction expansion as one of its provisions.

What is the ESOP dividend reinvestment provision? To answer the question, we first have to understand current law pertaining to dividends paid on stock in an ESOP. [Note, an ESOP is a tax-qualified defined contribution plan that must be primarily invested in employer securities that may borrow money to acquire employer securities. In other words, it is an ERISA plan that is akin to a tax-qualified profit sharing plan. An ESOP must comply with all the laws, regulations, and regulatory guidance pertaining to ERISA plans, plus many unique, Congressionally sanctioned incentives and restrictions to ensure ESOPs are both "ownership" plans, and secure "ERISA" plans.].

Internal Revenue Code Section 404(k) provides that dividends paid on ESOP stock are tax deductible if they are passed through in cash to the employee participants in the ESOP, or if they are used to pay the debt incurred by the ESOP in acquiring its employer securities, and the employees receive stock equal in value to the dividends. This section of the Code was added to the tax code in 1984, and modified in 1986, and in 1989.

The ESOP dividend reinvestment proposal, as set forth in Section 4 the ESOP Promotion Act of 1997, or H.R. 1592 provides that if a sponsor of an ESOP pays dividends on ESOP stock that may be passed through the ESOP in cash to the employee, and the employee in turn has indicated that he or she would like the dividends "reinvested" in the sponsor's dividend reinvestment program, the sponsor can still take the Section 404(k) deduction.

Now, to the second question asked above—Why would Mr. Ballenger, et al want to have this proposal become law. Well the reason is simple, but typical of most of our tax law, we have to be careful to make the simple explanation understandable.

The IRS has taken the position that when the employee voluntarily authorizes his or her dividends on his or her ESOP stock to be reinvested in the ESOP sponsor's dividend reinvestment program, the value of the dividends is not tax deductible for the ESOP sponsor.

Let me repeat what I just said—if the employee wants to reinvest his or her dividends on ESOP stock in more stock to be held in the ESOP or a co-ordinated 401(k) plan in order to have more savings, the IRS says, "No tax deduction." Think about it, the IRS is saying, "spend the money now, do not save it for the future," or at least that is the impact of the position.

But the situation in the real world gets even worse in the view of ESOP advocates, as there is a way for the plan sponsor to keep its tax deduction and for the employee to save more by keeping his or her dividends in a 401(k) plan. But this way is convoluted to a great extent, requiring the creation of some legal fictions that serve no purpose except to make life more complex and expensive for the sponsor of the ESOP and 401(k) plan.

Again, here is the explanation. There is a technique that the IRS has blessed in several letter rulings back in 1993 and 1994 that is called the 401(k) switchback. Getting a switchback program set up involves quite a bit of rigmarole, and I am not going to pretend that what follows is a perfect explanation of the technique.

In brief, under a suitable program, an ESOP participant is allowed to make an additional pre-tax deferral to the 401(k) plan equal to the amount of the ESOP dividends passed through to her or him. The plan sponsor then pays the ESOP dividends to the company payroll office, and there is a chain of paper that has established an agency relationship between the ESOP participant and the payroll office. [This is done by signing forms, etc. etc.].

If the ESOP participant elects the additional 401(k) deferral equal to her or his ESOP dividends, his or her paycheck would reflect the ESOP dividend amount and the additional pre-tax deferral to her or his 401(k) account. The paycheck has gone neither up or down for his or her personal tax situation.

Now an employee can elect not to make an additional 401(k) deferral, and thus have his or her dividend paid, and have personal tax liability on the amount.

As noted the IRS has held that the plan sponsor does not lose the ESOP dividend deduction in a switchback scheme as broadly outlined above if the dividends are first paid to the payroll office, and the employee has entered into a written agency agreement with the payroll office. I refer to Internal Revenue Private Letter Ruling 9321065.

One expert in designing these 401(k) Switchback programs writes,

> Because the dividend pass-through/401(k) switchback feature involves a considerable amount of work to implement with regard to treasury and payroll procedures (including software programming changes), the company will want to carefully assess the anticipated value of the program both in terms of the expected dividend deduction and enhanced employee ownership values.

Duncan E. Harwood, Arthur Anderson Consulting, LLP, "Dividend Pass-Through: Providing Flexibility," Proceedings Book, *The 1995 Two Day ESOP Deal,* Las Vegas, Nevada, page 158, The ESOP Association.

In short, enacting the ESOP dividend reinvestment proposal would simplify permitting and encourage people to save their dividends paid on ESOP stock in a manner that encourages the corporation to pay dividends in an employee owner arrangement, compared to accomplishing the same thing in a convoluted way.

Now, lets turn to the third question set forth at the beginning of this statement. Please remember the answer to this question would go a long way in determining whether the Congress will want to make the ESOP dividend reinvestment proposal law.

The answer to this question should be self-evident. The current IRS position is anti-savings and anti-simple. To encourage saving the dividends on ESOPs in a tax-qualified ERSIA plan in a manner that is simple and easy to understand, the ESOP dividend reinvestment proposal should become law.

Otherwise, we can all accept the IRS position that in order to encourage the savings of the ESOP dividends the plan sponsor should engage in some mumbo-jumbo involving the payroll office being an agent for employees who just happen to figure out how to increase their 401(k) elective deferrals and who tell their "agent" to put their dividends in the 401(k) plan.

In conclusion Mr. Chair, the ESOP and employee ownership community, in allegiance of sponsors of 401(k) plans and dividend reinvestment plans, believe that your focus on making our current retirement savings system better and to eliminate regulatory burdens will lead you and your colleagues to conclude that Congress should enact what was Section 4 of H.R. 1592, the ESOP Promotion Act of 1997, and Section 511 of H.R. 1102—the ESOP dividend reinvestment proposal.

And, let me pledge that the ESOP community will work with you, your colleagues, Committee staff, the staff of the Joint Tax Committee, and Treasury staff, to ensure that any legislative action on the ESOP dividend reinvestment proposal meets its intent to be a fair and reasonable provision of law, both in terms of application and revenue impact, that promotes savings, and employee ownership.

Again, I thank you for your leadership in the area of pension law, and for the leadership of the Oversight Subcommittee of the Ways and Means Committee.

Statement of Investment Company Institute

The Investment Company Institute[1] is pleased to submit this statement to the Subcommittee on Oversight of the House Committee on Ways and Means to address retirement savings issues raised at its March 23 hearing. Most importantly, we would like to take this opportunity to indicate our strong support for many of the provisions of H.R. 1102, the "Comprehensive Retirement Security and Pension Reform Act of 1999." H.R. 1102 would make the nation's retirement plan system significantly more responsive to the retirement savings needs of Americans. The Institute commends the sponsors of this bill and other members of this subcommittee for their interest in retirement savings policy.

Retirement savings is of vital importance to our nation's future. Although members of the "Baby Boom" generation are rapidly approaching their retirement years, recent studies strongly suggest that as a generation, they have not adequately saved for their retirement.[2]

Additionally, Americans today are living longer. Taken together, these trends will place an enormous strain on the Social Security program in the near future.[3] In order to ensure that individuals have sufficient savings to support themselves in their retirement years, much of this savings will need to come from individual savings and employer-sponsored plans.

The Institute and mutual fund industry have long supported efforts to enhance the ability of individual Americans to save for retirement in individual-based programs, such as the Individual Retirement Account or IRA, and employer-sponsored plans, such as the popular 401(k) plan. In particular, we have urged that Congress: (1) establish appropriate and effective retirement savings incentives; (2) enact saving proposals that reflect workforce trends and saving patterns; (3) reduce unnecessary and cumbersome regulatory burdens that deter employers-especially small employers—from offering retirement plans; and (4) keep the rules simple and easy to understand.

It is our view that H.R. 1102 achieves these objectives.

I. Establish Appropriate and Effective Incentives to Save for Retirement

In order to increase retirement savings, Congress must provide working Americans with the incentive to save and the means to achieve adequate retirement security. Current tax law, however, imposes numerous limitations on the amounts that individuals can save in retirement plans. Indeed, under current retirement plan caps, many individuals cannot save as much as they need to. One way to ease these limitations is for Congress to update the rules governing contribution limits to employer-sponsored plans and IRAs. Increasing these limits will facilitate greater retirement savings and help ensure that Americans will have adequate retirement income.

H.R. 1102 contains several provisions that would address this issue, which the Institute strongly supports. Section 101 of the bill would increase 401(k) plan and 403(b) arrangement contribution limits to $15,000 from the current level of $10,000; government-sponsored 457 plan contribution limits would increase to $15,000 from the current level of $8,000. Section 101 also would modify the section 401(a)(17) limit on compensation that may be taken into account to determine benefits under qualified plans by reinstating the pre–1986 limit of $235,000, indexed in $5,000 increments. The current limit is $160,000. Another important provision of H.R. 1102 would repeal the "25% of compensation" limitation on contributions to defined contribution plans. These limitations can prevent low and moderate-income individuals from saving sufficiently for retirement. (As is noted below, the repeal of these limitations is also necessary in order to enable many individuals to take advantage of the "catch-up" proposal in the bill.)

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[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,446 open-end investment companies ("mutual funds"), 456 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $5.662 trillion, accounting for approximately 95% of total industry assets, and have over 73 million individual shareholders.

[2] The typical Baby Boomer household will need to save at a rate 3 times greater than current savings to meet its financial needs in retirement. Bernheim, Dr. Douglas B., "The Merrill Lynch Baby Boom Retirement Index" (1996).

[3] Social Security payroll tax revenues are expected to be exceeded by program expenditures beginning in 2014. By 2034, the Social Security trust funds will be depleted. 1999 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds

In addition to these proposals, the Institute urges Congress to increase the IRA contribution limit. The IRA limit remains at $2,000-a limit set in 1981. If adjusted for inflation, this limit would be at about $5,000 today. IRAs are especially important for individuals with no available employer-sponsored plan through which to save for retirement. H.R. 1102 proposes such an increase, but limits its availability only to individuals able to make a fully deductible contribution under current income-based eligibility rules.

This targeted approach complicates these rules, which already are too confusing. Indeed, when Congress imposed the current income-based eligibility criteria in 1986, IRA participation declined dramatically-even among those who remained eligible for the program. At the IRA's peak in 1986, contributions totaled approximately $38 billion and about 29% of all families with a head of household under age 65 had IRA accounts. Moreover, 75% of all IRA contributions were from families with annual incomes less than $50,000.[4] However, when Congress restricted the deductibility of IRA contributions in the Tax Reform Act of 1986, the level of IRA contributions fell sharply and never recovered—to $15 billion in 1987 and $8.4 billion in 1995.[5] Among families retaining eligibility to fully deduct IRA contributions, IRA participation declined on average by 40% between 1986 and 1987, despite the fact that the change in law did not affect them.[6] The number of IRA contributors with income of less than $25,000 dropped by 30% in that one year.[7] Fund group surveys show that even more than a decade later, individuals do not understand the eligibility criteria.[8]

Based on these data, the Institute recommends that the increase in the IRA contribution limit that is proposed in H.R. 1102 be extended to all taxpayers by repealing the complex eligibility rules, which deter lower and moderate income individuals from participating in the program. A return to a "universal" IRA would result in increased savings by middle and lower-income Americans.

II. Enact Savings Proposals That Reflect Workforce Trends and Savings Patterns

On average, individuals change jobs once every five years. Current rules restrict the ability of workers to roll over their retirement account from their old employer to their new employer. For example, an employee in a 401(k) plan who changes jobs to work for a state or local government may not currently take his or her 401(k) balance and deposit it into the state or local government's pension plan. Thus, the Institute strongly supports Sections 301 and 302 of H.R. 1102, which would enhance the ability of American workers to take their retirement plan assets to their new employer when they change jobs by facilitating the portability of benefits among 401(k) plans, 403(b) arrangements, 457 state and local government plans and IRAs.

The laws governing pension plans also must be flexible enough to permit working Americans to make additional retirement contributions when they can afford to do so. Individuals, particularly women, may leave the workforce for extended periods to raise children. In addition, many Americans are able to save for retirement only after they have purchased their home, raised children and paid for their own and their children's college education. Section 201 of H.R. 1102 would address these concerns by permitting additional salary reduction "catch-up" contributions. The catch-up proposal would permit individuals at age 50 to save an additional $5,000 annually on a tax-deferred basis. The idea is to let individuals who may have been unable to save aggressively during their early working years to "catch up" for lost time during their remaining working years. Section 202's repeal of the "25% of compensa-

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[4] Venti, Steven F., "Promoting Savings for Retirement Security," Testimony prepared for the Senate Finance Subcommittee on Deficits, Debt Management and Long-Term Growth (December 7, 1994).

[5] Internal Revenue Service, Statistics of Income.

[6] Venti, supra at note 4.

[7] Internal Revenue Service, Statistics of Income.

[8] For example, American Century Investments asked 534 survey participants, who were self-described "savers," ten general questions regarding IRAs. One-half of them did not understand the current income limitation rules or the interplay of other retirement vehicles with IRA eligibility. Based on survey results, it was concluded that "changes in eligibility, contribution levels and tax deductibility have left a majority of retirement investors confused." "American Century Discovers IRA Confusion," *Investor Business Daily* (March 17, 1997). Similarly, even expansive changes in IRA eligibility rules, when approached in piecemeal fashion, require a threshold public education effort and often generate confusion. *See, e.g.*, Crenshaw, Albert B., "A Taxing Set of New Rules Covers IRA Contributions," *The Washington Post* (March 16, 1997) (describing 1996 legislation enabling non-working spouses to contribute $2,000 to an IRA beginning in tax year 1997).

tion" limit could further enhance the ability of Americans to "catch-up" on their retirement savings.

The "catch-up" is an excellent idea and sorely needed change in the law. We believe it could be made even more effective by exempting the catch-up contributions from nondiscrimination testing. A similar proposal is contained in S. 646, the "Retirement Savings Opportunity Act of 1999," introduced by Senator Roth (R–DE) and Senator Baucus (D–MT).

III. EXPAND RETIREMENT PLAN COVERAGE AMONG SMALL EMPLOYERS

The current regulatory structure contains many complicated and overlapping administrative and testing requirements that serve as a disincentive to employers, especially small employers, to sponsor retirement plans for their workers. Easing these burdens will promote greater retirement plan coverage and result in increased retirement savings.

Meaningful pension reform legislation must focus on the need to increase pension plan coverage among small businesses. Although these businesses employ millions of Americans, less than 20 percent of them provide a retirement plan for their employees. By comparison, about 84 percent of employers with 100 or more employees provide pension plans for their workforce.[9]

Unnecessarily complex and burdensome regulation continues to deter many small businesses from establishing and maintaining retirement plans. The "top-heavy rule" is one example of such unnecessary rules.[10] A 1996 U.S. Chamber of Commerce survey found that the top-heavy rule is the most significant regulatory impediment to small businesses establishing a retirement plan.[11] The rule imposes significant compliance costs and is particularly costly to small employers, which are more likely to be subject to the rule. It is also unnecessary because other tax code provisions address the same concerns and provide similar protections. While the Institute believes the top-heavy rule should be repealed, Section 104 of H.R. 1102 would make significant changes to the rule, which would diminish its unfair impact on small employers.

H.R. 1102 also would reduce the start-up costs associated with establishing a pension plan for small employers by providing a tax credit to small employers of up to 50% of the start-up costs of establishing a plan up to $1,000 for the first credit year and $500 for each of the second and third year after the plan is established. This would encourage more small employers to establish retirement plans by diminishing initial costs.

The Institute also strongly supports expanding current retirement plans targeted at small employers. Specifically, the Institute supports expansion of the SIMPLE plan program, which was instituted in 1997 and offers small employers a truly simple, easy-to-administer retirement plan. The SIMPLE program has been very successful. An informal Institute survey of its largest members found that as of March 31, 1998, these companies were custodians for an estimated 63,000 SIMPLE IRA plans and approximately 343,000 SIMPLE IRA accounts. The SIMPLE program is especially popular among the smallest employers—those with under 25 employees. Indeed, the vast majority (about 90%) of employers establishing these plans have under 10 employees.

H.R. 1102 would strengthen the SIMPLE program in two ways, each of which the Institute strongly supports. First, H.R. 1102 would raise the SIMPLE plan contribution limits from $6,000 to $10,000. This would address the current "penalty" to which individuals who work for a small employer are subject. Individuals should not be disabled from saving for retirement merely because they work for a small employer. Second, H.R. 1102 would provide for a salary-reduction-only SIMPLE plan. This would make the program much more effective for employers of 25–100 employees.

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[9] EBRI Databook on Employee Benefits (4th edition), Employee Benefit Research Institute (1997).

[10] The top-heavy rule is set forth at Section 416 of the Internal Revenue Code. The top-heavy rule looks at the total pool of assets in a plan to determine if too high a percentage (more than 60 percent) of those assets represent benefits for "key" employees. If so, the employer is required to (1) increase the benefits paid to non-key employees, and (2) accelerate the plan's vesting schedule. Small businesses are more likely to have individuals with ownership interests working at the company and in supervisory or officer positions, each of which are considered "key" employees, thereby exacerbating the impact of the rule.

[11] Federal Regulation and Its Effect on Business—A Survey of Business by the U.S. Chamber of Commerce About Federal Labor, Employee Benefits, Environmental and Natural Resource Regulations, U.S. Chamber of Commerce, June 25, 1996.

IV. Simplify Unnecessarily Complicated Rules

H.R. 1102 recognizes the need to keep the rules simple in the case of both IRAs and employer-sponsored plans. As we have noted above, complex and confusing rules diminish retirement plan formation and significantly reduce individual participation in retirement savings programs. We strongly support numerous provisions in H.R. 1102 that would simplify rules. We discuss several of these provisions below.

Section 205 of the bill would simplify the required minimum distribution rules applicable to distributions from qualified plans and IRAs. The bill would exempt from the rule the first $100,000 of assets accumulated in an individual's defined contribution plans and the first $100,000 accumulated in an individual's IRAs (other than Roth IRAs, which are not subject to the rule). This proposal provides individuals with smaller account balances with relief from a complex and burdensome rule.

The bill also would provide a new automatic contribution trust nondiscrimination safe harbor. This safe harbor would simplify plan administration for employers electing to use it, enabling them to avoid costly, complex and burdensome testing procedures.[12] This provision is also an effective way to increase participation rates in 401(k) plans, especially the participation rates of non-highly compensated employees.

H.R. 1102 also would modify the anticutback rules under section 411(d)(6) of the Internal Revenue Code in order to permit plan sponsors to change the forms of distributions offered in their retirement plans. Specifically, the bill would permit employers to eliminate forms of distribution in a defined contribution plan if a single sum payment is available for the same or greater portion of the account balance as the form of distribution being eliminated. This proposed modification of the anticutback rule would make plan distributions easier to understand, reduce plan administrative costs and continue to adequately protect plan participants. In addition, H.R. 1102 would permit account transfers between defined contribution plans where forms of distributions differ between the plans; this modification of the anticutback rule also would simplify plan administration. It would also enhance benefit portability, which, as noted above, is an important public policy objective.

Finally, H.R. 1102 contains other provisions that would simplify currently burdensome rules and which the Institute supports. These proposals include repeal of the multiple use test and simplification of the separate line of business rules.

V. Conclusion

Improving incentives to save by increasing contribution limits and accommodating the saving patterns of today's workforce will provide more opportunities for Americans to save effectively for retirement. Simplifying the rules applicable to employer-sponsored plans and IRAs would result in a greater number of employer-sponsored plans, a higher rate of worker coverage and increased individual savings. The Institute strongly supports the provisions described above and commends the sponsors of H.R. 1102 for supporting reforms of the pension system that will increase plan coverage and encourage Americans to save for their retirement. We encourage members of this Committee and Congress to enact this legislation this year.

Statement of Edward J. Curry, Executive Vice President, Moore Products, Co., Spring House, PA

Mr. Chairman and Members of the Subcommittee:

Thank you for allowing me the opportunity to present my views for the record to the Subcommittee on Oversight as it examines the role of private employer pensions—which are so critical to America's workforce—and the need for reform.

My name is Edward J. Curry and I am the Executive Vice President and Chief Operating Officer of Moore Products, Co. Moore Products Co. is a global leader in providing manufacturers with innovative solutions to process measurement and control challenges. The Company's instruments and control systems help increase plant safety and productivity, reduce time to market, and improve quality in industries such as chemical, pharmaceutical, pulp and paper, oil and gas, and power. The Company's dimensional measurement systems facilitate inspection and quality control for discrete parts manufacturers in industries such as automotive and aeronautical.

[12] To qualify for the safe harbor, employers would need to make automatic elective contributions on behalf of at least 70% of non-highly compensated employees and match non-highly compensated employee contributions at a rate of 50% of contributions up to 5% or make a 2% contribution on behalf of each eligible employee.

Founded in 1940, Moore Products, Co. has grown into an international operation with 120 representative offices worldwide. We are publicly traded on NASDAQ and our headquarters is located in Spring House, PA. Moore Products, Co., has 1200 employees and in 1998 reached $168 million in sales.

We are engineering and technology driven and are operating in a world of rapid technological change. Software is at the heart of this change and is now the core of the products that we manufacture. There is an intense competition for talent in this industry and it is thanks to talented engineers and software developers that Moore Products Co. has been able to maintain a competitive edge in the world. But to stay competitive, we must be able to attract and retain more of these highly skilled workers.

As an employer, we have a long history of sharing with our employees. Specifically, Moore Products, Co., offers competitive salaries; provides health care coverage that is 100 percent funded by the employer; offers a 401(k) savings plan and a defined benefit pension plan; and, offers a dental plan, a life insurance benefit, a disability plan, and an education plan.

We offer this benefit package in order to attract and retain the highest quality employees. The changing workforce, however, has different requirements and we as employers want to respond to those needs. For example, software engineers give us little credit for our defined benefit plan. Rather, they prefer equity in the company. Because these employees are essential for our continued success, we want to modify our benefits package to satisfy those demands. Specifically, we want to supplement the retirement benefits afforded through our defined benefit pension plan by enabling our employees to access the plan's excess assets under a program that our employees will better appreciate—a stock bonus plan. Unfortunately, we are unable to give our workers this additional benefit because the Tax Code currently imposes a prohibitively high tax on such transactions.

At present, we have a defined benefit plan with assets of $139 million. Our liabilities, as defined by the Pension Benefit Guaranty Corporation, are only $66 million. That creates an excess of $73 million. We would like to unlock this overfunding and create a stock bonus plan whereby employees would be given clear title to these excess pension plan assets through equity in the company. Stock bonus plans make a company more competitive, create long term wealth for all employees, result in a more equitable distribution of wealth, and provide a strong connection between the employee and the success of the employer.

Under current law, however, we are unable to change the form of our pension benefits in this way because a transfer of excess assets from our defined benefit plan into a stock bonus plan would require us to terminate the pension plan and would be taxed as a reversion. Section 4980(a) of the Internal Revenue Code imposes an excise tax of 20 percent on the amount of assets reverting to the employer from a qualified plan. In addition, the excise tax increases to 50 percent unless the employer (a) transfers 25 percent of the excess assets to a qualified replacement plan or (b) provides benefit increases in the terminating plan equal to at least 20 percent of the excess assets. Such transactions also subject the employer to income tax on the amount of the surplus over 25 percent of the excess, whether or not it is transferred to the replacement plan. We have no desire to terminate our defined benefit pension plan. Further, the excise taxes, coupled with the gross income tax consequences—a combined total exceeding 85 percent—make a transfer of excess assets from our defined benefit plan into a stock bonus plan cost prohibitive, despite the fact that we wish to transfer all of the surplus on participants' behalf.

We therefore would support a proposal to amend section 401(a) to permit an employer to transfer excess assets under on ongoing defined benefit plan to a stock bonus plan of the same employer. Under such a proposal, the amount of the defined benefit plan's surplus assets would be determined under ERISA rules relating to the valuation of plan assets and liabilities as if the plan had terminated. More importantly, however, under this proposal, the defined benefit plan *would not need to be terminated*, so participants' plan participation would remain unchanged.

Participants would be further protected in three ways: (1) an appropriate "cushion" amount, determined as a percentage of surplus assets, should be required to remain in the defined benefit plan; (2) all active employees under the plan would be fully vested in their accrued benefit, determined as of the transfer date; and (3) the proposal would require that the defined benefit plan *could not be terminated* before the end of the fifth plan year following the year of the transfer.

Under such a proposal, excess assets transferred to the stock bonus plan would not be included in gross income of the employer, would not be deductible by the employer, and would not be treated as an employer reversion under section 4980. By adopting this approach, the best features of both define benefit pension plans and stock bonus plans can be combined to enhance retirement security for workers while removing the prohibitive costs of such transfers.

We believe businesses that convert excess plan assets into another acceptable retirement vehicle should *not* fall under the rules in section 4980. We do not think changing the form of the retirement plan in which surplus assets are held should be characterized as a "reversion" because the employer would not be taking ownership of any of the retirement funds. Rather, the pension assets would continue to remain in a pension trust and participants' benefits would be enhanced and remain protected.

We believe that a proposal such as the one described above could be designed to expand benefit coverage as well as provide additional protection and security for employees in a number of ways. First, the stock bonus plan could be required to cover at least 95 percent of the active participants in the defined benefit plan who are employees of the employer immediately after the transfer date. Thus, virtually all of the active participants in the defined benefit plan would benefit from the surplus assets through participation in the stock bonus plan. Second, participants would be fully vested in the benefits under the stock bonus plan established with the excess assets. Further, the transferred surplus could be allocated as employer nonelective contributions—it would not be conditioned on any employee contribution. This enhances retirement security for lower-and moderate-income workers. Finally, the transferred assets could be required to be allocated no less rapidly than ratably over the seven year period beginning with year of the transfer ensuring that the additional benefits are provided to workers in a timely manner.

The proposal would also encourage the continuation and maintenance of defined benefit pension plans by providing added flexibility for employers to create new retirement plans with surplus assets. Allowing employers this flexibility eliminates the disincentive associated with defined benefit plans that make it difficult to devote significant amounts of surplus assets to types of retirement benefits that the PBGC has found are more highly appreciated by employees. Moreover, the proposal specifically encourages employers to continue to maintain their defined benefit plans, rather than to terminate and then extract a reversion of the surplus assets.

In summary, the proposed change in the law would be highly protective of participants in defined benefit plans, would encourage the continued maintenance of such plans by employers, and would guarantee virtually universal coverage under the employer's new stock bonus plan to defined benefit plan participants so that they can benefit from their defined benefit plan's surplus.

We would encourage the Congress to support rules that seek to protect defined benefit plan assets by discouraging reversions and we support the growing move toward increased employee ownership. We view a proposal that adds flexibility to defined benefit pension plans and permits the movement of plan assets between retirement vehicles as consistent with the underlying spirit of both those goals. Our defined benefit plan is overfunded thanks to a long tradition of conservative funding practices because we share the belief that promised employee pension benefits should be protected. In addition, we are seeking to put those excess assets to a more productive use by transferring them into another retirement trust—a stock bonus plan—that demonstrates our commitment to the benefits of employee ownership.

The law should not penalize an employer for seeking to transfer a portion of surplus defined benefit plan assets for allocation to employees into another form of retirement plan that is more highly appreciated by the workforce and is encouraged by the Tax Code itself as a tool to attract and retain talented employees.

I would recommend that this Subcommittee consider making a change to current law, along the lines of what we have described above, that would enable an employer like Moore Products Co. to respond to the needs of its workforce and allow the transfer of excess defined benefit plan assets into a stock bonus plan to be accomplished without the imposition of income or excise taxes.

Thank you for your consideration.

Statement of National Coordinating Committee for Multiemployer Plans

The National Coordinating Committee for Multiemployer Plans ("NCCMP") appreciates the opportunity to testify at the March 23, 1999, hearings of the House Ways and Means Subcommittee on Oversight, and to submit this statement for the record, on the Comprehensive Retirement Security and Pension Reform Act (H.R. 1102) introduced last month by Representatives Portman and Cardin.

The NCCMP is the only national organization devoted exclusively to protecting the interests of the approximately ten million workers, retirees, and their families who rely on multiemployer plans for retirement, health and other benefits. The NCCMP's purpose is to assure an environment in which multiemployer plans can continue their vital role in providing benefits to working men and women. In furtherance of this purpose, the NCCMP monitors the development of laws and regulations relating to the structure and administration of multiemployer plans. The more than 240 Affiliate and Associate Affiliate members of the NCCMP encompass plans and plan sponsors in every major segment of the multiemployer plan universe. The NCCMP is a nonprofit organization.

At the outset, the NCCMP would like to express its support for H.R. 1102 ("the bill" or the "Portman-Cardin bill"). The NCCMP particularly appreciates the explicit consideration and thoughtful attention given to issues specifically relating to multiemployer plans and to the advances that the bill would make in promoting defined benefit pension plans, which we believe provide the strongest promise of real retirement income security for working Americans.

This statement focuses on selected provisions of the bill having particular relevance for NCCMP affiliates, and supplements our March 23 written and oral testimony in support of the bill's reforms in Code [1] section 415 limits as they apply to multiemployer plans.

1. SECTION 415 LIMITS

a. The Dollar Limit

The NCCMP has long supported relief from the dollar limits under Code section 415 and strongly supports the proposal in the bill to raise the retirement-age dollar limit on annual benefits from $130,000 to $180,000. Although $130,000 is currently far higher than all but the rarest pension under a typical multiemployer plan benefit, the limit does present problems when it is actuarially reduced for early retirement in the manner currently required by the Code

Many multiemployer plans offer unreduced or subsidized pensions after what amounts to a full career in the industry, such as 25 or 30 years. These plans typically cover people whose jobs involve very physically demanding work (such as roofers, ironworkers, carpet-layers and other construction workers), who may have started working in the industry directly from high school. Under these circumstances, it is often unrealistic for a plan participant to expect or try to work much past his early or mid-fifties. Because these multiemployer plan participants commonly retire ten to fifteen years or more before Social Security retirement age, the required actuarial adjustment under section 415 can dramatically reduce the pensions they are allowed to receive. Because of this drastic reduction, multiemployer plan participants who are no longer physically able to maintain full-time employment must retire with incomes well below what they have earned through years of hard work.

For these reasons, we have long supported the bill's proposal to treat multiemployer plans like the plans of government and tax-exempt organizations for purposes of applying the section 415 limits to early retirement. Currently, the plans of government and tax-exempt organizations are subject to a floor below which the section 415 dollar limits may not be reduced when adjusted for early retirement. The bill proposes amending Code section 415(b)(2)(F) to establish that the actuarial reduction for early retirement under those types of plans cannot reduce the dollar limit below $130,000 per year for benefits beginning at or after age 55, and the actuarial equivalent of $130,000 per year at age 55 for benefits beginning before age 55. This provision would do a great deal to alleviate the harsh effects of the dollar limit on multiemployer plan participants who retire early.

b. The Compensation Limit

The NCCMP has also long supported, and now embraces, the bill's proposal to exempt multiemployer plans from the compensation limit under Code section 415. Code section 415(b)(1)(B) limits the benefits that can be paid in a year to the average of the participant's compensation for the three consecutive calendar years in which compensation was the highest. The compensation limit can have a particularly harsh effect on lower paid participants in multiemployer plans. Because multiemployer plans typically base a participant's annual retirement benefit on the worker's total covered service and do not take compensation into account, a low paid worker who has worked in the trade for many years may end up with a benefit that

[1] All references to the Code shall be to the Internal Revenue Code of 1986, as amended.

exceeds the average of his highest three years of compensation. Limiting the benefits of these workers—the lowest paid workers—runs counter to section 415's overall purpose of preventing highly paid employees from sheltering too much money in pension plans.

Also, the working patterns of participants in multiemployer plans differ from those of participants in single-employer plans such that the average of the three highest years of compensation may result in an artificially low amount. In the typical single-employer context, the steady increase of wages due to inflation means that a participant's highest paid three years will often be his last three years. However, participants in multiemployer plans, particularly in physically demanding industries, may find it difficult as they grow older to find steady or continuous work. As a result, the highest three years of compensation may have been many years ago when the participant was younger and able to work more steadily. In that case, however, the participant is deprived of the increases in wages occasioned by inflation over the years. Even if the worker has been able to avoid physical debility, work in these industries is often episodic. A worker's best years may be interrupted by breaks that keep them from being consecutive. Again, application of the section 415 limits to multiemployer plans turns the policy behind section 415 on its head—rather than protecting against abuses by high paid workers, the limits deprive lower paid workers of the full benefits they have rightfully earned.

c. Aggregation

The bill also provides that multiemployer plans need not be aggregated with any other plans for purposes of applying the section 415 limits. The NCCMP would welcome this change because it would make the section 415 limits much simpler to administer. Under current Treasury regulations, multiemployer plans are not required to be aggregated with other multiemployer plans for purposes of applying the section 415 limits. The Treasury regulations acknowledge that multiemployer plan sponsors would face enormous administrative difficulties (and substantial expense) if required to identify every contributing employer for whom a participant worked in order to ensure that a benefit paid to the participant does not violate section 415. The bill codifies this administrative simplification and extends it such that multiemployer plans need not be aggregated with single-employer plans either for purposes of the section 415 limits.

This change in the rule would be particularly helpful in the context of applying the de minimis rule under section 415 which permits plans to avoid section 415 testing for benefits under $10,000 per year. Under the rule proposed in the bill, plans could simply pay these small benefits without incurring the substantial administrative costs involved in determining whether the participant had ever been covered by, for example, a 401(k) plan of the employer.

d. Defined Contribution Limit

The NCCMP also supports the proposal in the bill to increase the compensation limit for defined contribution plans to 100% of compensation. In multiemployer defined contribution plans, employers typically agree to make the same hourly contribution for all covered employees, regardless of what each of them is paid. Further refinement of the contribution obligation would create confusion and expense for contributing employers, who are often small companies that do not have sophisticated payrolls systems. The defined contribution compensation limitation poses a problem in the context of multiemployer plans that cover people at widely different pay levels, such as apprentices and journeymen. Since they are just learning their craft, apprentices are paid substantially less than journeymen. When the same dollar amount of contributions is credited to their plan accounts, it represents a larger percentage of their section 415 compensation. The plan administrator is not in a position to monitor or alter the contribution in order to ensure that it stays within the 25% of compensation limit. It is certainly an unfortunate anomaly that this limit prevents the lowest paid workers from taking full advantage of contributions made on their behalf to defined contribution plans. This example is just one of many which illustrates that increasing the benefit limits for multiemployer plans will provide greater retirement benefits to lower paid, rank and file workers, rather than focusing primarily on benefits for wealthy executives, professionals, business owners, and the others for whom the limits were intended.

e. Conclusion

Relief from the section 415 limits has long been a major priority for the NCCMP and we very much appreciate the thoughtful treatment these issues receive in the Portman-Cardin bill. The changes proposed would go a long way towards relieving workers from the harsh limits that have often prevented them from receiving the full benefits they have worked so hard to earn.

1. Deduction Limits

We support the proposal in the bill to give multiemployer plans the same right as single-employer plans to override the general deduction limits under section 404 of the Code and fund up to the amount of "unfunded termination liability (determined as if the proposed termination date referred to in section 4041(b)(2)(A)(i)(II) of the Employee Retirement Income Security Act of 1974 [2] were the last day of the plan year)." The NCCMP believes that allowing deductible contributions to be made in an amount sufficient to insure full funding, as measured by a readily identifiable actuarial standard, is a positive change that will protect the sound funding of multiemployer pension plans. It may be advisable to confirm in legislative history that single-employer Title IV termination liability (otherwise inapplicable to multiemployer plans), rather than some adaptation of the special Title IV rules applicable to multiemployer plans (regarding withdrawal liability), is nonetheless the standard for determining this deduction limit. The single-employer measurements will be much more readily determinable and therefore less expensive and confusing to apply.

The bill also contains two provisions relating to the deduction limits for profit-sharing plans. First, the bill proposes to exclude from the section 404 deduction limits elective deferrals under 401(k) plans. Second, the bill increases the maximum deductible amount for contributions to stock bonus and profit-sharing trusts from 15% to 25% of compensation with compensation defined to include elective deferrals. The NCCMP supports both of these proposals. Multiemployer plans offer many types of benefits to their participants, and we applaud these increases in the deduction limits because they will remove impediments to the establishment of multiemployer capital-accumulation, 401(k) and other savings plan in industries where the union and employers agree that such arrangements are appropriate.

2. Vesting Upon Partial Termination

Like many others, the NCCMP has long recognized that the Code's partial termination rules are inappropriate for multiemployer plans, and therefore typically inapplicable to them. Therefore, we strongly support the bill's provision to codify a formal multiemployer plan exemption from the Code's requirement that upon a partial termination, affected participants become vested to the extent the plan is funded.

Generally speaking, a partial termination occurs when an employer excludes a substantial portion of a plan's participants from plan coverage. In multiemployer plans, of course, the actions of any one employer do not affect the broader base of plan coverage, or the opportunity of the people who worked for that employer to continue their coverage under the plan by taking a job with another contributing employer—or, often, with an employer elsewhere in the country that contributes to another multiemployer plan with which the first plan is linked through a reciprocity agreement.

Even looking beyond the circumstances of individual workers and employers, given the cyclical, even seasonal, nature of the industries in which multiemployer plans are most frequently encountered, a drop in coverage for a substantial number of participants at any given time may be temporary (such as, for instance, upon completion of a major local construction project). The affected employees may well return to plan coverage when work in the area again picks up. Participants may move in and out of a given plan's jurisdiction throughout their careers, as the level of available work covered by the plan rises and falls with market conditions. Among other things, it could be very difficult to determine when a multiemployer plan has experienced the permanent substantial decline that is the hallmark of a partial termination.

Furthermore, multiemployer plans do not present the potential for abuse that the partial withdrawal rules were meant to foreclose. The partial termination rules were intended to prevent discriminatory plan funding and abusive reversions of plan assets to employers. This possibility does not exist in the context of multiemployer plans because these plans are, by definition, broad-based in their coverage—those remaining in the plan are rank and file workers, just like those leaving the plan—and the Taft-Hartley Act and ERISA prohibit reversions of assets to employers contributing to multiemployer plans.

[2] Hereinafter "ERISA."

3. 401(k) Safe Harbor—Definition of Compensation

The NCCMP supports the proposal to revise the definition of "compensation" used for purposes of the 401(k) safe harbors. To make 401(k) savings opportunities fully available to multiemployer groups, the ADP tests have to be reasonably adapted to the administrative capabilities of multiemployer plans. Multiemployer plan benefits are rarely directly related to participants' pay and plan administration is wholly independent of the contributing employers and their payroll systems. As a result, it would be difficult and expensive for multiemployer plans to try to obtain full compensation data on all eligible employees, and would create new reporting burdens for the contributing employers. Without an accommodation of some type in the comparative deferral testing required for 401(k) plans, many multiemployer groups might find themselves barred, as a practical matter, from using that type of retirement savings program. Given the egalitarian nature of multiemployer plan coverage and benefit formulas, the safe harbor based on a 3% of compensation employer contribution for everyone offers, in concept, the perfect solution.

Contributions to multiemployer plans, however, are typically based on regular hours. Most plans can determine the negotiated wage level for a regular hour of work based on the applicable collective bargaining agreements. Participants' compensation, on the other hand, may include premiums for overtime and other irregular compensation. Identifying those hours and calculating total compensation in a way that gives proper weight to the hours of premium pay would be next to impossible for a plan. The bill proposes to define compensation, for 401(k) safe harbor purposes, in a manner that allows the exclusion of "all irregular and additional compensation." This would make it clear that multiemployer plans can use the 401(k) safe harbors based on a definition of compensation which can be determined on the basis of data that is reasonably available to them.

4. Tax Credit for Establishing Qualified Plans

The NCCMP supports the proposal in the bill to provide a tax credit for small employers who adopt qualified plans. The NCCMP applauds this effort to encourage employers to contribute to their employees' retirement and wants to ensure that otherwise eligible small employers who adopt multiemployer plans will be entitled to receive such tax credits. The proposal speaks in terms of the costs of establishing a plan in a way that appears to contemplate the creation of a new plan rather than signing up for an existing plan. Of course, we assume that the intent is to provide the credit regardless of the manner in which the employer introduces the qualified plan coverage, for example, even if the employer subscribes to an existing prototype plan.

Unlike the typical single-employer plan, the costs associated with setting up and running a multiemployer plan are embedded in the employer contribution rates, as it is those contributions, plus fund earnings, that pay for plan operations. The individual employer in a multiemployer pension plan generally does not incur significant direct administrative expenses in connection with adopting a multiemployer plan, other than whatever systems adjustments they must make to be sure that they calculate and pay the required contributions properly and timely. Although plan administrative expenses are not assessed to each employer separately, these costs are no less real to small employers adopting multiemployer plans and those employers should not forfeit the tax credit solely because of the collectively bargained and financed nature of the plans they offer. Consequently, we suggest that the legislative history clarify that, for eligible employers adopting multiemployer plans, the plan's administrative costs may, if calculated as a percentage of required contributions for the plan as a whole, be treated as "qualified startup costs" within the contemplation of the proposed tax credit. (This overall percentage would be multiplied by the employer's actual contributions during the applicable period to establish "qualified startup costs.")

5. Benefit Statements

At present, multiemployer plans are exempted by ERISA from the obligation to provide, upon the request of the participant, a benefit statement showing the participant's total benefits accrued and the portion of such benefits which are vested (or the earliest date on which they will become vested). It is more difficult for multiemployer than for single-employer plans to issue such statements because multiemployer plans frequently do not have ready access to all of the information necessary to calculate an individual active participant's total accrued and vested benefits, including, especially, verified records of service with different contributing employers during different time intervals and at different contribution levels (all of which may yield differing benefit accruals). Some plans use validated statistical data for funding, but verify individual covered service and other variables only at the time of retirement.

The new reporting requirement could increase administrative burdens and costs for NCCMP affiliates. Nevertheless, we support the goal of making retirement income information available to workers while they still have time to adjust their financial planning. To accommodate the multiemployer plan data dilemma, we would propose that there be included in the legislative history confirmation that multiemployer plans may include with the requested benefit statement a disclaimer indicating that the statement is based upon the information reasonably available to the plan at that time and that the participant's actual benefit may be different once all relevant facts are determined.

6. Permissive Aggregation of Collectively Bargained and Non-Collectively Bargained Employees for Non-Discrimination Testing

The NCCMP supports the proposal in the bill to permit employers to aggregate the pension coverage they provide for collectively bargained employees with coverage under plans for non-bargained employees for purposes of showing that their non-bargained plans meet the minimum coverage requirements of Code section 410(b). We believe that the current rule requiring disaggregation of bargained and non-bargained employees in all cases is unfair to employers who contribute to pension plans for their collectively bargained workers, since they cannot take that coverage into account when the IRS judges the nondiscriminatory nature of their other pension plans. We do not believe an employer providing pensions for its rank and file workers should get credit for that coverage if those workers are not represented by a union, but not get credit when they are.

Of course, it should be made clear that this permissive aggregation in no way affects the fact that, under Code sections 401(a)(4), 410(b) and 413(b), as implemented by the applicable Treasury regulations, retirement plan coverage for collectively bargained employees is treated as automatically meeting the general discrimination and minimum coverage standards.

7. Retirement Planning Services

The NCCMP strongly supports the bill's proposal permitting employers to provide retirement planning services to their employees on a tax-free or salary-reduction basis. The NCCMP applauds any effort to foster employees' understanding of their future retirement income needs.

8. Suspension of Benefits Notices

The NCCMP welcomes, in certain circumstances, the additional flexibility afforded by the proposal in the bill permitting the suspension of benefits notice requirements under ERISA section 203 to be met by a description in the summary plan description. We endorse this proposal, however, only as it applies to participants who continue working past normal retirement age without interruption. With respect to these participants, it does not makes sense to issue a notice that benefits have been suspended when the participant has not yet begun receiving benefits and, because he was still working, did not anticipate that benefits would commence. On the other hand, participants who retire, commence receiving benefits, and then subsequently return to work, may be surprised if benefits stop. We believe that responsible plan administration would call for a separate, contemporaneous notice to affected re-employed retirees, explaining that their benefits are being suspended. Some additional leeway on the precise timing of that notice, though, would be welcome, particularly in multiemployer cases where the plan may not learn of the retiree's return to prohibited employment until several months after the fact.

9. Effective Date

Section 101 of the bill, which generally increases various dollar limits, has a delayed effective date for collectively bargained plans: the later of the January 1, 2000 or the date on which the current collective bargaining agreement expires but no later than January 1, 2004. The NCCMP appreciates the sensitivity of the bill's drafters to the general need for sponsors of collectively bargained plans to have advance warnings so that they can adapt to new rules when they next have the opportunity to bargain over benefits and compensation. Here we suspect that the delayed effective date is intended to protect collectively bargained plans against an abrupt change in required funding as the ceiling on benefits is lifted. However, because we doubt that this will be a problem for the majority of multiemployer plans and we know how eagerly their participants and retirees await section 415 relief, we suggest that the bill allow the sponsors of collectively bargained plans to apply the new limits earlier, while keeping the delayed outside date for those plans for which the change might cause a problem.

For the multiemployer plan participants who are affected by the section 415 limits as they apply to early retirement, it seems unduly harsh to force them, in every case, to live through several more years of underpayments even when their plans can afford to restore their full benefits. In the majority of cases, the percentage of retiring participants in any given plan who would be affected by the 415 limits is likely to be small enough that no significant funding issues will be raised by the change in the benefit limits. In the event the changes in the section 415 limits would create a funding issue for the plan, plan sponsors could choose not to elect the earlier effective date so that they have an opportunity to negotiate the necessary funding. Congress took a very similar approach to the one we suggest in establishing the effective date of the GATT rules for calculating lump sum benefits—plan sponsors had to comply by an outside date, but could choose to do so earlier.

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The NCCMP appreciates the opportunity to submit this statement on the provisions of the Portman-Cardin bill which are of particular importance to multiemployer plans. Please contact the NCCMP at (202) 737–5315 if you have any questions or would like additional information.

[Attachments are being retained in the Committee files.]

PENSION RIGHTS CENTER
March 23, 1999

Dear Chairman Houghton:

We are writing to commend you and the other members of the Subcommittee on Oversight for convening today's hearing on pension issues and applaud your objective of exploring how to make the pension system "even better" by improving the features of existing plans and having more workers participate in the system.

As the nation's only consumer organization dedicated solely to improving the retirement income security of American workers, retirees, and their families, the Pension Rights Center is painfully aware of the dire consequences of not having an adequate private pension system. Accordingly, for the past 23 years the Center has worked with retiree, employee and women's organizations to secure a wide range of pension reforms, among them increased pension coverage and reduced vesting for workers and important protections for divorced women and widows.

Although we believe additional reforms are urgently needed, we recommend that before Congress pursues additional legislation, it first take the time to develop a clear blueprint for the private retirement income system. In the 25 years since the enactment of the Employee Retirement Income Security Act of 1974, ERISA and the Internal Revenue Code have been amended numerous times. Each time, Congress thought it was improving the laws—and there have been many improvements benefiting millions of American families—but as the result of continued tinkering, the laws have become more complex, fragmented, and confusing for workers and employers alike. And most importantly, the proportion of the workforce covered by private retirement plans has not grown. Lower income, minority, and women workers are still the least likely to be earning private pensions.

The need for such a blueprint is illustrated by the provisions of H.R. 1102, the Comprehensive Retirement Security and Pension Reform Act of 1999. Although this legislation includes several helpful measures, such as those that would ease the transferability of savings plan assets, and reduce the number of years employees must work under a savings plan before earning the right to an employer's matching contributions, most of the provisions represent a smorgasbord of tax breaks for higher earners and cutbacks in protections for rank and file workers. As noted in the enclosed analysis, these provisions are likely to decrease, rather than increase, the proportion of future retirees receiving adequate incomes. They will also inevitably widen the already disturbingly wide income gap among the elderly.

We would be pleased to meet with you and Subcommittee staff to discuss our analysis and recommendations for reforms that could achieve your important objective of "having more workers participating in retirement plans with even better features."

Sincerely yours,

Michele L. Varnhagen
Policy Director
Karen W. Ferguson
Director
enc.

The Widening Gap

On March 11, 1999, Congressman Rob Portman (R–OH) and Congressman Benjamin Cardin (D–MD) introduced H.R. 1102, the Comprehensive Retirement Security and Pension Reform Act.[1] According to a summary prepared by the sponsors of the legislation, its 62 provisions seek to make retirement security available to millions of workers by:

> expanding small business retirement plans, allowing workers to save more, addressing the needs of an increasingly mobile workforce through portability and other changes, making pensions more secure, and cutting the red tape that has hamstrung employers who want to establish pension plans for their employees.

Although the legislation might well increase the number of employer-sponsored retirement plans, it is unlikely to significantly increase the number of workers who receive benefits under those plans. Moreover, by encouraging more companies to shift from company-paid traditional pensions to employee-paid voluntary savings plans, the major provisions of the bill could significantly increase income inequality among older Americans.

An Overview of the Portman-Cardin Bill

H.R. 1102 consists of 62 sections contained in five titles. The major provisions of the bill are in Title I. These are aimed at increasing the amount of tax deferred dollars that employees can contribute to retirement savings plans, such as 401(k), 403(b), 457 and SIMPLE plans. The legislation proposes both to increase the limits directly, for example, by allowing employees to reduce their taxable incomes up to $15,000 a year by contributing to a 401(k) plan,[2] and indirectly, by cutting back on protections that are designed to spur employers to encourage contributions by their employees (or, when that fails, to contribute on their behalf.) As noted below, these provisions may well increase the retirement incomes of individuals who can afford to take full advantage of the new rules (at a significant revenue loss), but will do nothing for the overwhelming majority of workers who either cannot afford to contribute anything, or only very little, to these plans.

Also, to the extent that these provisions would make savings plans more attractive than conventional plans, they could actually jeopardize retirement security by encouraging employers to drop existing pension plans and substitute savings arrangements.[3]

Other provisions of Title I are directed at traditional pension plans. Again, the emphasis is on increasing limits that currently apply to these plans and minimizing measures that are meant to ensure that benefits flow to workers at all income levels, not merely higher-paid management employees. These provisions, designed to increase the attractiveness of plans, have significant revenue loss implications. Completely missing from the bill are measures to assure a fairer distribution of the heavily tax subsidized benefits provided by these plans to low and moderate income workers.

Title II contains two provisions that would increase retirement security. One relates to the rights of spouses of certain federal employees and would remedy alongstanding inequity. The second would give most workers a vested right to their employers' matching contributions to 401(k) plans after 3 years, a realistic provision, since few employees realize that the matching contributions can be now forfeited if they change jobs before they have worked 5 years.

But Title II also contains a provision that, like the provisions in Title I, would benefit primarily well-off individuals looking for tax breaks. Touted as a "catch-up" provision, it allows everyone age 50 or older to reduce their taxable income by making additional contributions of up to $5,000 each year to their 401(k) plans. Such a provision might make sense if limited to lower and moderate-income individuals to compensate for years in which they were serving as care givers, but it is not so limited.

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[1] The bill was introduced with 14 co-sponsors.
[2] Or by $20,000 if they 50 years old or older.
[3] Between 1984 and 1994 there was a 66% decline in the number of pension and profit sharing (non-401(k)) plans, and a 30% decline in participation in these traditional plans.

Title III is captioned "Increasing Portability for Participants." In fact, its provisions would merely make it easier to transfer assets that are being cashed out from one type of savings plans to another. Although there is nothing wrong with removing barriers to rollovers, this is not what most workers think of as "portability". Title III also allows employees whose companies have been acquired by or merged with other companies but continue to work for the successor company to cash out their 401(k)s accounts. If modified to apply only to employees who have reached the plan's early retirement age, the provision would bring the treatment of 401(k)s in these situations into conformity with the treatment of distributions from other types of plans.

Titles IV and V contain major cutbacks in critical financial information now required to be provided to workers and retirees, including the all-important Summary Annual Report now automatically provided to plan participants. In addition, two provisions relating to the disclosure of benefit information seek to forestall the enactment of disclosure requirements proposed in other bills, including one that would alert workers to the loss of expected benefits when their plans are converted to cash balance arrangements. In addition, these titles contain proposals that could reduce the rights of workers in multiemployer plans and diversified companies.

Analysis of Key Provisions of H.R. 1102

I. Provisions Affecting Savings Plans

Background. Since the early 1980's policymakers have been experimenting with measures designed to encourage employers to offer their workers the opportunity to provide for their own retirement through tax sheltered voluntary savings plans. The proponents of these measures seek to shift responsibility for retirement savings from employers to employees. In the words of an IBM executive the objective is to change the role of corporations from "providers" of retirement income to "facilitators" of individual savings.

Although this experiment is extremely popular, all indications are that it is failing. Even the most outspoken advocates of do-it-yourself arrangements, are recognizing that, despite multimillion dollar educational campaigns aimed at encouraging employees to contribute, little new money is being accumulated for retirement. Much of the money in 401(k)-type savings plans is either money that has been switched from non-tax sheltered savings vehicles, or is being used for non-retirement purposes, such as housing and education.

Of even greater concern, is the shift from traditional plans that provide pensions to workers at all income levels to savings plans that typically only benefit those who can afford to contribute. Principally to save on labor costs, tens of thousands of companies have jettisoned traditional pensions in favor of these savings plans.[4] Larger companies have typically retained their traditional plans, but have effectively frozen them, and are telling their employees that they will have to rely primarily on their 401(k)s if they want to be able to pay their bills in retirement.[5]

The bottom line is that most people have accumulated very little in their retirement savings plans. The most recent government figures show that half of all households with these have less than $15,680 in their accounts. The numbers for individuals are even more disturbing. Half of all men with 401(k)-type plans have less than $10,000 in their accounts. The median account balance for women is $5,000. Even more troubling is the unequal distribution of retirement savings plan accumulations. In 1995, 57% of all 401(k)-type assets were owned by the nation's top one-tenth wealthiest households.

Section 101. Increasing the Amounts Better-Off Employees Can Contribute

Section 101 of the bill is captioned "Restoration of limits formerly in effect" but it goes much further. It would significantly increase the amounts of tax deferred contributions that employees and employers can make to retirement savings plans.

The limits for the amounts employees can contribute to 401(k) plans each year would increase from $10,000 to $15,000. In addition, the combined employer-em-

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[4] Experts note that companies can reduce their retirement costs by two-thirds or more by substituting savings plans for pensions. The reason is that unlike pensions, where contributions are made for workers at all income levels, employers only contribute to savings plans (if they contribute at all) for those employees who can afford to put money into the plan.

[5] This shift may have serious consequences not only for individual economic security, but also for national economic growth. This is because employer contributions to pensions are the largest component in the personal savings rate. During the past decade employer contributions to pension have been cut in half, in part because of the move to 401(k)s. This may help explain the the continuing drop in the savings rate. See "Savings Rate Hits Negative Territory," Washington Post, November 3. 1998.

ployee contributions to these plans would increase to from the lesser of $30,000 or 25% of pay to a straight $45,000 a year. These increases would be combined with a provision in Title II that would allow anyone age 50 or over to contribute an additional $5,000 a year.[6]

The contribution increase clearly will only benefit high wage earners. According to the Joint Committee on Taxation, 71% of income tax filers earn less than $50,000 a year, 15% earn between $50,000–75,000 and 12% earn between $75,000–200,000. If the median $25,000 a year employee contributes 20% of pay, that $5000 is well under the current limits. Even a $50,000 worker can contribute 20% of pay under current law.

The limits for mini-401(k)s, known as SIMPLE plans would increase from $6,000 to $10,000, and the limit for tax deductible IRA contributions would increase from $2,000 to $5,000.

These provisions are extremely troubling from a tax policy perspective. They would dramatically reduce federal revenue, with the cost (in the form of higher taxes or fewer government services) being borne by lower and moderate income workers who cannot afford to take advantage of these extremely generous tax shelters. At the same time, all indications are that the individuals who would take advantage of these higher limits already have substantial accumulations of retirement income, through their pensions and savings plans, as well as other ample sources of non-tax sheltered wealth. These people do not need additional tax incentives to save.

Although the argument is made that higher limits will encourage more employers to adopt savings plans, there is no documentation to support this contention. Moreover, other sections of the bill significantly diminish the already small likelihood that these plans would benefit individuals who would not otherwise save for retirement.

Before action is taken to raise savings plan limits, Congress should consider directing the Treasury to conduct a comprehensive study of how many people would take advantage of the increased limits, their income levels, the extent which they are now saving in other non-tax sheltered forms and/or have other sources of retirement income, and what the likely cost to the nation would be would be in terms of lost pension coverage and lost revenue.

Section 103. Eliminating Employer Matches in SIMPLE Plans

SIMPLE plans are savings plans for small employers. Current rules provide that any employer with 100 or fewer employees can establish a SIMPLE plan if s/he offers to match the contributions of eligible employees dollar for dollar up to 3% of pay. Even if no employees accept the offer, the employers can contribute up to $6,000 for themselves and match that with another $6,000 in employer contributions. The concept is that the availability of the employer match will encourage employees who might not otherwise contribute to put money into the plan.

Section 103 would permit employers to offer salary reduction only Simple plans, with no employer matches. This would, in effect, be a payroll deduction IRA with higher limits. Higher-paid employees, who do not need tax incentives to encourage them to save, would contribute, and their tax breaks would be subsidized by other employees who would not contribute. No social objective would be served by these plans.

Section 104. Cutting Back on Top-Heavy Plan Protections

A long-standing legislative objective of consultants and financial institutions that sell and service private retirement plans has been the elimination of so-called "top-heavy" rules, particularly in 401(k) plans. The rules apply to plans where 60 percent of the amounts accumulated in the plan are in the accounts of company owners and officers. They provide that if a savings plan meets the 60% threshold and is, therefore, "top-heavy," the employer must contribute 3% of pay to the accounts of rank and file employees.

The effect of these provisions is to provide an incentive to encourage employers to educate their employees about the desirability of making contributions to 401(k) plans. If the educational effort fails, the company owners and officers can still put the full $30,000 maximum employer-employee contribution into their own accounts as long as they put small amounts into 401(k) accounts for their workers. (A worker earning $20,000 would get a contribution of $600 a year.)

Section 104 contains a number of provisions designed to effectively nullify the top-heavy rules. The most direct assault is on top-heavy 401(k) "safe harbor" plans.

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[6] Section 201 discussed below.

Safe harbor 401(k)s are new this year. Unlike other 401(k)s they are not subject to ''nondiscrimination'' rules that link the amounts higher-paid employees can contribute to 401(k)s to the amounts contributed by other employees. As with a SIMPLE plan, an employer with a safe harbor 401(k) simply offers to match the contributions of eligible employees who can afford to put money in the plan. (The required match is a dollar for dollar match on the first 3% of pay contributed by the employee, and 50 cents on the dollar for the next 2% of pay.)

In a safe harbor 401(k) the employer has no incentive to encourage the employees to contribute. If none of the employees accept the offer of the matching contributions, the employers can still contribute the total 401(k) employer-employee contribution of $30,000 or 25% of pay for themselves. In other words, but for the protection provided by the top-heavy rules, it would be possible to have a 401(k) where none of the employees received any benefits from the tax subsidized plan.

The bill would reduce top heavy protections in other 401(k) plans in several different ways. It proposes not to count employee contributions in figuring whether the plan meets the 60% test, and to only measure the 60% by looking at contributions in a particular year, rather than the total account balances. It would also redefine who is in the top-heavy class by including only company officers earning more than $150,000 a year as key employees, and would include employer matches in figuring the 3%. The result of enactment these measures might well be the creation of more plans, but there would also be a reduction in retirement income security, particularly where employers conclude that a top-heavy 401(k) plan is much cheaper (and more beneficial to the owner's), and therefore more attractive, than a plan, such as a Simplified Employee Pension (SEP) that delivers benefits to workers at all income levels.

Income inequality among the elderly in this country, is already far greater than that in our global competitors (and greater than among active workers.) In part, this is because people with pensions and Social Security have twice the income of retirees living on Social Security alone. The focus of public policy should be on narrowing, not widening this already great income disparity.

Section 304. Accelerated Vesting for 401(k) Matching Contributions

A provision in the bill affecting savings plans likely to increase income security, is Section 304, which would reduce the number of years required to vest in 401(k) employer matching contributions from five years to three.[7] This would conform to workers' expectations. Few are put on notice that the matching contributions used to entice their participation in the plan will be forfeited if they leave the plan before they have worked five years for the employer.

II. PROVISIONS AFFECTING PENSION AND PROFIT SHARING PLANS

Sections 101, 105, 111, and 401. Proposals to Raise Limits

H.R. 1102 contains a variety of provisions to raise limits on contributions, benefits and funding of traditional pension and profit sharing plans. The rationale for the provisions relating to increases in benefits and contributions is that there is a need to make existing plans more attractive to company owners and officers, impart to give them a stake in the plans, and to discourages them from relying so heavily on non-qualified ''executives-only'' plans for their own retirement incomes.

To our knowledge there is no documentation showing that increasing limits would change behavior patterns in existing plans. Moreover, raising the ceilings, particularly the limitation on compensation, might well result in the reduction of other workers' benefits.

If the Treasury can afford the revenue loss resulting from raising the limits for benefits and contributions, these increases should be targeted toward new plan designs that meet the needs of lower and moderate income workers. Specifically, such plans should not be integrated with Social Security, should not be backloaded or age weighted, and should cover 100% of an employer's workers in a single line of business. Excellent starting points for such new plan designs are the SAFE legislation introduced by Congresswoman Nancy Johnson and Congressman Earl Pomeroy and the Pension ProSave legislation developed by Senator James Jeffords and Senator Jeff Bingaman.

Modification of the full funding limit to reflect the need for funding for projected benefit obligations would be helpful to plans and participants alike. However, it is important to note that many plans are burning up against the full funding limit solely because they have stopped improving benefits for workers and retirees. The

[7] There is also an alternative graded vesting schedule. Matching contributions in safe harbor 401(k)s are immediately vested.

percentage of participants in plans providing occasional cost of living adjustments in their retirees' pensions has dropped from 50% to less than 10% in recent years.

Section 513. Proposal to End Partial Terminations of Multiemployer Plans

Section 513 is an effort to forestall litigation on behalf of participants in multiemployer plans. In recent years, former construction workers on the Alaska pipeline have successfully claimed that the dramatic decline in participation in their plans after the pipeline was completed created a "partial termination" entitling them to become immediately vested in their pensions despite their relatively short periods of service under the plan. The legislation would deny other participants in multiemployer plans the right to claim partial terminations under the terms of their plans.

Sections 403, 407, 521, 523 and 525. Disclosure Provisions

The legislation includes provisions that would eliminate important financial and benefit information now received by participants.

The two most draconian cutbacks are the proposed elimination of the automatic Summary Annual Report that provides participants with an overview of their plans' finances, and the suspension of benefits notice that goes to pensioners in multiemployer plans who return to work covered by the plan.

The bill also seeks to block other pending legislation that would assure that workers in traditional pension plans that are converted to cash balance plans be notified of the extent to which their expected benefits are likely to be reduced, and provides less meaningful benefit information than would be available other proposed legislation. It would deny participants in plans with 25 or fewer participants all information about the financial status of their plans.

Section 204. Survivors Benefits for Spouses of Deferred Vested Civil Servants

Section 204 would remedy a disturbing inequity affecting the spouses of participants in the Civil Service Retirement System. This system, which affects federal employees who started work before 1984, now denies survivors benefits to widows and widowers if the federal employee leaves government service and dies before applying for a pension. It is an important provision that has been introduced into previous Congresses and has been overlooked for too long.

Statement of Principal Financial Group, Des Moines, IA

This statement is submitted by The Principal Financial Group, a family of insurance and financial services with assets of $82.3 billion. Its largest member company, Principal Life Insurance Company, is currently the eighth largest life insurance company in the nation based on 1997 assets. The Principal Financial Group provides retirement plan investment and administrative services to more than 43,000 employers, the majority of whom employ fewer than 100 employees.

The Principal appreciates the opportunity to comment on retirement security and pension reform. In recent years, Congress has strengthened the employer-sponsored retirement system and improved the retirement security of many American workers. In particular, the pension simplification provisions enacted by the Small Business Job Protection Act of 1996 (Public Law 104–18) and the Taxpayer Relief Act of 1997 (Public Law 105–34) have helped ease plan administration and helped more small employers establish retirement plans for their employees. Nevertheless, the Principal believes more can, and should, be done to encourage employers to establish and maintain retirement plans. We believe the Comprehensive Retirement Security and Pension Reform Act (H.R. 1102), introduced by Representatives Rob Portman and Benjamin Cardin, will help achieve these goals.

The passage of H.R. 1102 will help the U.S. private pension system by:

- Encouraging more plans to be formed,
- Allowing U.S. workers to contribute more to their retirement plans,
- Simplifying existing overly complex rules,
- Making it easier to preserve plan assets for retirement, and
- Addressing women's pension equity issues.

We offer the following comments on the provisions in H.R. 1102:

Retirement Plan Limits

The Principal supports the proposed increases to the various dollar limits. Increases in the dollar limits will encourage employers to establish plans by allowing them to accumulate benefits in an amount comparable to the amounts accumulated by lower paid employees. Existing non-discrimination rules—such as the 401(k)/(m) nondiscrimination tests and the 415 maximum benefit limits—will ensure that plans do not discriminate in favor of the highly compensated employees.

We also support repealing the 25 percent of pay limit on annual additions under a defined contribution plan. This limit has little effect on the most highly paid employees while adversely affecting lower paid employees who choose to contribute generously to their 401(k) plans. Repealing the percent of pay limit would allow lower paid employees to increase their retirement savings.

Administrative Costs

We're pleased H.R. 1102 includes provisions which will reduce administrative costs and burdens which have a disproportionate impact on small employers. Specifically, allowing matching contributions to be counted toward satisfying the top-heavy minimum required contribution and modifying the definition of key employee will help small employers comply with these rules. Elimination of the multiple use test for 401(k)/(m) plans will also simplify the nondiscrimination test and reduce the administration burden on plan sponsors. We also strongly support the provisions that promote good faith compliance and correction of plan errors rather than plan disqualification and IRS sanctions. This feature will encourage self-correction without penalizing inadvertent violations of the qualified plan rules.

Portability

We are particularly pleased with the liberalization of the transfer and rollover rules and the modification of the same desk rule for 401(k) plans. Corporate acquisitions, mergers, dispositions and voluntary job changes are more and more frequent today. Each of these incidents can have a huge impact on an employee's retirement savings. As employees change jobs, keeping track of their retirement accounts from several different plans is often difficult and time consuming. The best way to do this is to make it easier for employees to transfer these distributions to qualified plans or roll them over to an IRA. The provisions in H.R. 1102 will preserve plan assets by making it easier to transfer benefits between 401(a), 403(b) and 457 plans. The bill also eliminates the "same desk rule" that prevents employees in 401(k) plans from receiving a distribution in certain corporate take-over situations.

Participant Security

The Principal supports provisions that would increase participant security. Specifically, we support requiring faster vesting of employer matching contributions and allowing members age 50 or older to make additional contributions of up to $5,000 per year to 401(k), 403(b), 457 and SIMPLE plans. We also support provisions that would require defined contribution plan members to receive annual benefit statements and defined benefit plan participants to receive benefit statements every three years.

Tax Credit for Small Employers

We support the tax credit for small employers to offset the costs of setting up and administering a new plan. Many employers feel the costs associated with running a retirement plan prohibits them from establishing a plan. This is especially true for small employers whose decision to sponsor a plan is impacted by the cost of the plan. This tax credit will help offset the cost of establishing a retirement plan and will encourage more small employers to set up a plan.

Highly Compensated Employee

We do not support the provision that would eliminate the employer's option to count only the top-paid 20 percent of employees who earn more than $80,000 when determining the number of employees who are considered to be highly compensated employees. While most employers are not affected by this option, there is a small percentage of businesses that have a large proportion of their workforce earning more than $80,000. These businesses include computer programmers, engineers, and sales representatives whose bonus income push them over the earnings limit. This option should be preserved.

Defined Benefit Plans

H.R. 1102 includes several new 401(k) safe harbors designed to encourage plan sponsorship—the automatic contribution trust and the deferral only SIMPLE plan. More should be done to encourage employers to establish and maintain defined benefit plans. We urge the Committee to consider adding a simplified defined benefit plan for small employers to reduce existing administrative costs and hassles that make defined benefit plans unattractive to many employers.

SUMMARY

The Principal believes that more small employers will establish retirement plans if we can make those plans more attractive for the employer and his/her highly compensated employees. We should educate plan sponsors about the types of plans that are available, provide incentives—such as tax credits for start-up costs and increased dollar limits—for employers to establish such plans, and then make plan administration less costly and less time consuming. The provisions in H.R. 1102 will accomplish much of this. We strongly urge Congress to enact these provisions this year.

FOR MORE INFORMATION

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Statement of Lynn Franzoi, Senior Vice President, U.S. Chamber of Commerce

My name is Lynn Franzoi, and I am Senior Vice President for Benefits for Fox Group. I also chair the Qualified Plans Subcommittee of the U.S. Chamber of Commerce, on whose behalf I submit these comments.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region of the country. I am pleased to express the Chamber's support for H.R. 1102, the Comprehensive Retirement Security and Pension Reform Act, sponsored by Congressmen Rob Portman (R–OH) and Ben Cardin (D–MD). This bill is critical to ensure the retirement security of future generations of retirees.

REGULATORY RELIEF THAT WILL HELP EXPAND COVERAGE

The U.S. Chamber believes that any meaningful pension reform legislation must focus on changes that will increase retirement plan coverage. A special emphasis should be placed on the small business community. The current regulatory environment under which plans must operate acts as a major deterrent to plan sponsorship, especially among small employers. Considering that the majority of today's new jobs are created in the small business sector, the Chamber is concerned that the complexity of our pension laws works to deny millions of Americans access to retirement plan options through their employer.

We believe the following provisions of the Portman-Cardin legislation are particularly important in expanding retirement plan coverage to more employees.

A. Top heavy relief: The top heavy rules enacted in 1982 have not achieved their objective of expanding coverage, particularly for low paid employees of small employers. Qualified plans were already subject to strict nondiscrimination rules. The top heavy rules merely piled on by imposing additional rules that raised the threshold cost of plan sponsorship too high to permit the objectives of the top heavy rules to be achieved. Thus, instead of coverage increasing, the top heavy rules discouraged plan sponsorship in the first instance.

A plan is considered "top heavy" if more than 60% of the plan's assets are held by "key employees." Because small businesses have a smaller pool of workers accruing benefits than large companies, they are more likely to be subjected to these onerous requirements. Top heavy plans must make special required contributions which substantially add to the plan's cost. For example, for top heavy 401(k) plans, the small business owner must generally make a three percent of compensation contribution on behalf of *all* employees, not just those participating in the 401(k) plan. Even if the company is making matching contributions to the plan, it must also make top heavy contributions above and beyond the regular employer match, since the regular match does not count towards fulfilling top heavy requirements under current law.

Though the Chamber supports full repeal of top heavy rules, H.R. 1102 is an important step in the right direction by enabling employers to count regular employer matching contributions towards top heavy minimum employer contributions, modifying the definition of "key employee," and disregarding employee elective deferrals for purposes of top heavy calculations.

B. Reduced PBGC premiums: Another important provision for small businesses would allow new defined benefit plans with less than 100 participants to pay a per-participant flat $5 premium and no variable rate premium to the Pension Benefit Guaranty Corporation for the first five years of the plan. Larger plans having to pay a variable rate premium would be able to pay a reduced phased-in premium for the first five years of the plan.

Current law creates a catch–22 for new defined benefit plans. Credit for past service is often included as a part of the new plan, yet fully funding that past service credit immediately is limited in the tax code by funding restrictions. As a result, even though a plan is considered by the IRS to be properly funded, PBGC considers the same plan to be underfunded, since the past service credit has not been substantially funded in the initial years of the plan due to IRS restrictions. Thus, the plan is subject to costly variable rate premiums, on top of the regular premiums they already pay.

The provision in H.R. 1102 to reduce premiums for new defined benefit plans is an important example of an area in which employer costs can be reduced without negatively impacting the safety of workers' or retirees' benefits.

C. Current liability full funding limit: In an effort to raise revenue for unrelated tax provisions, in the 1980s Congress redefined how defined benefit plans are to be funded and the circumstances in which they are deemed to be fully funded by imposing a "current liability" standard, rather than the projected "future liability" costs. Defined benefit pension benefits accrue benefits more rapidly in the final years of a worker's career. By creating funding limits based on current liability, the law restricts businesses from funding the promised benefit evenly over an employee's active service. The law back-loads future pension obligations (similar to a balloon-payment loan), resulting in an intimidating pension liability for the employer as his or her workers approach retirement age.

H.R. 1102 repeals the current liability full funding limit for years beginning after December 31, 2002. Repeal of this provision will add stability to pension funding obligations for employers, making defined benefit plans a more workable retirement option.

D. Tax credit for new retirement plans: The Portman-Cardin legislation, like the Clinton Administration proposal, establishes a new tax credit for small businesses starting a new retirement plan to help offset the administrative costs of establishing the plan. Specifically, the tax credit would be for 50 percent of expenses, up to a maximum credit of $2,000 for the first year and $1,000 for the second and third years.

The Chamber believes this provision recognizes the importance of helping businesses—especially small businesses—by easing the administrative start-up costs of a retirement plan. The tax credit is an important marketing tool that will help employers make the initial transition to retirement plan sponsor, and will help expand coverage to more workers.

E. Repeal of multiple use test: Under current 401(k) rules, plans are subject to the "multiple use test," which is in addition to the nondiscrimination tests that already apply to employee contributions and employer matching contributions. This is a particularly onerous and complicated rule that few plan administrators understand, making compliance difficult at best. Also, considering the nondiscrimination testing that already applies to 401(k) plans, the multiple use test is overkill. H.R. 1102 would eliminate the multiple use test, which the Chamber considers to be an unnecessary administrative compliance requirement imposed on plans that does not enhance protections for plan participants.

F. Separate line of business rule: Another administrative complexity for certain employers is the "separate line of business" (SLOB) rule. The Chamber submits that this provision of the Internal Revenue Code, which is designed to allow employers to test their retirement plans on a separate-line-of-business basis, is simply unworkable and serves no valid purpose in its present form. Thus, we support proposals that would simplify the SLOB rule and allow for the allocation of employees along lines of business based upon a facts and circumstances test, as H.R. 1102 directs.

G. ESOP dividend reinvestment: Current law permits an employer to deduct the dividends paid on employer stock held in an employee stock ownership plan (ESOP), provided the dividends are paid to the participant in cash or the dividends are used to repay a loan on a leveraged ESOP. If a plan allows participants to elect between receiving dividends in cash and having the dividends reinvested in the ESOP, the employer is allowed to deduct only those dividends that are paid in cash to participants; the employer may not deduct the dividends that are reinvested in the ESOP.

By allowing employees to elect to reinvest their company ESOP dividends paid on their ESOP shares, and allowing the employer a deduction for such reinvested dividends, H.R. 1102 will enhance employee stock ownership while increasing retirement savings.

H. 25 percent profit sharing plan: H.R. 1102 allows the creation of a profit sharing plan which fully utilizes the 25% of compensation (section 404) deduction limit. Currently, such a plan may be structured only as a money purchase plan under which contributions must be made whether or not the employer is profitable. The bill would also allow elective deferrals to be excluded from the definition of compensation for purposes of the deduction limits. This provision accomplishes the same goal as H.R. 352, legislation introduced earlier this year by Congressman Roy Blunt (R–MO) which the Chamber supports.

ENHANCING BENEFITS FOR WORKERS

In addition to expanding retirement plan coverage to a greater number of workers, H.R. 1102 will also enhance coverage for many who are already participating in a plan. Some of the provisions that will accomplish this include:

A. Restoring limits: The Chamber believes that Americans should be encouraged to save for their retirement to the best of their financial ability. To accomplish this, Congress must seek to foster an environment in which such savings can occur. The Chamber has long supported restoring the benefits and compensation limits that apply to qualified plans, to their historic limits.

Historically, retirement policy has allowed highly compensated employees to accrue a significant retirement benefit as long as those benefits accrued in a nondiscriminatory manner, so that lower paid employees also benefited. A series of additional limitations placed on contributions and benefit accruals, however, has seriously eroded the ability of highly compensated employees to benefit under such nondiscriminatory plans. As a result, benefits for executives have often been shifted to non-qualified plans that are unfunded. This diminished sense of involvement has eroded support for qualified plans while, ironically, altering, but not reducing, executives' benefits.

The Chamber has long supported restoring contribution and benefit limits as a means of strengthening incentives for owners to offer a qualified plan to their employees. The general nondiscrimination rules will continue to apply, thereby assuring protections for rank-and-file employees. We are pleased that Congressmen Portman and Cardin have included the restoration of these limits as a section of their bill, as we believe it will have a tremendous positive effect on plan sponsorship.

B. Repeal of 25% of compensation limit: Current law limits the total amount of money from the employer and employee that can be contributed per year to a defined contribution plan to the lesser of $30,000 or 25 percent of compensation. By retaining only the $30,000 limit, H.R. 1102 allows more lower and middle income workers to increase retirement contributions. For example, it will eliminate situations in which employees are forced to reduce the amount they are contributing to their 401(k) because their employer's profit sharing and matching contribution push them over the 25 percent limitation. This is more likely to occur in instances where employer contributions are a flat, across-the-board contribution, rather than a percent of pay. For example, since the total amount a $20,000 per year worker could have contributed (from the employee and employer) to his or her account would be just $5,000—considerably less than the $30,000 limitation that highly paid workers (those earning over $120,000) would be subject to.

Catch-up contributions: In the last several years, policymakers have begun to focus on something families have known for ages—the ability to save for retirement varies at different points in their lives. Periods of time in which the family gets by on just one income, or is paying for college, or has an unexpected job layoff, to cite a few common examples, all contribute to a not-uncommon temporary inability to save for retirement.

To reflect this reality, various bills have been introduced that enable workers to "catch up" on their retirement savings. One approach, which is reflected in H.R. 1102, allows workers over age 50 to make extra contributions of up to $5,000 per year to their defined contribution plan. While the Chamber enthusiastically supports this concept, there are significant technical defects in the proposal. The bill does not exempt catch-up contributions from nondiscrimination rules. Without such an exemption, companies will have difficulty in allowing their workers to take advantage of the additional $5,000 contribution amount, thereby sharply limiting its intended impact. Even with an exemption from nondiscrimination rules, however, creating a separate class of workers—those over age 50—who would be eligible to make contributions under a different set of rules would be administratively complex.

For the millions of businesses that are members of the Chamber, it is imperative that any catch-up provision be strictly voluntary in nature, so that business owners can choose to offer the option or not. Further, the catch-up provision must avoid complex compliance rules, such as requiring the establishment of separate "over–50" accounts or similar administrative complexities. As you know, Mr. Chairman, retirement plans comprise an extremely complicated area of tax and labor law, and a catch-up policy that added to that complexity is strongly opposed by the Chamber.

D. Roth 401(k) and 403(b) plans: Senate Finance Committee Chairman William Roth (R–DE) has introduced legislation that would create a new type of 401(k) or 403(b) plan, modeled after his successful Roth IRA bill. This provision, which also appears in H.R. 1102, would allow workers to choose whether to make contributions to their plan on a pre-tax or post-tax basis. Those who chose the post-tax option would not be subject to income taxes on earnings upon withdrawal, the same as for Roth IRAs. Because of the administrative complexity of determining which contributions are made pre-tax and which are post-tax, it is imperative that employers be given the option of offering a Roth IRA, without mandating it. The Chamber supports the employer-optional Roth 401(k) and 403(b) plans outlined in H.R. 1102.

E. Portability: The employer-sponsored retirement plan world has shifted dramatically in the direction of defined contribution plans in the last decade. When coupled with a trend towards shorter job tenure, many workers will end up with numerous defined contribution and IRA accounts by the time they retire. In broadly bipartisan proposals, numerous members of Congress have supported breaking down the barriers that keep workers' retirement plan money in assorted different places.

The ability to consolidate one's retirement money is important for several reasons. First, studies have shown that employees are less likely to spend retirement money once their account balance reaches critical mass, but are more likely to cash it out if the balance is small. By keeping retirement funds linked together, account balances will accrue faster, which should decrease leakage. Second, the ability to roll IRA money into a retirement plan offers the individual access to a professionally managed portfolio, such as a family of funds, that helps the worker diversify his or her retirement savings. Placing all of one's retirement money in a single mutual fund does not create a diversified portfolio, whereas being able to choose from a selection of funds, all managed through the plan, provides the worker with easy access to a diversified portfolio.

It is important to note that the Roth and Portman-Cardin bills allow the employer the option to not accept rollovers from other plans or from IRAs. Although we do not anticipate this feature of the bill to add significantly to administrative costs, it is still essential that employers be given the option whether or not to offer such a benefit.

F. Change in vesting schedule: H.R. 1102 includes a provision that would decrease the amount of time that a worker must be employed by a company before that worker is vested to three years, from current law's five years. Additionally, the graded vesting schedule is reduced so that the employee is fully vested after five years. The Chamber opposes reducing the vesting schedule below current law. Given that employers have a finite amount of money to spend on employee benefits, coupled with ever-increasing health care costs, reduced vesting will make it harder for employers to attract and retain longer-term workers by offering meaningful retirement benefits.

G. New 401(k) safe harbor: H.R. 1102 creates a new 401(k) safe harbor entitled the "Automatic Contribution Trust" for plans that automatically enroll newly eligible participants. The plan must also make contributions of at least three percent of compensation for those employees who do not opt out of the plan; at least 70 percent of lower-paid workers must be contributing to the plan; and the employer must provide at least a two percent nonelective contribution or a 50 percent match up to five percent of compensation. All contributions would have to be 100% vested. Plans that follow this safe harbor formula would be exempt from ADP, ACP, and top heavy requirements. The Chamber supports this provision.

H. Same desk rule: The same desk rule places restrictions on a participant's access to retirement benefits when they work in the same position for a new employer following a sale of their former employer's assets. Employees faced with this change in business ownership should have access to their retirement benefits from their former employer. We support the provision in H.R. 1102 that modifies the same desk rule.

I. Multiemployer plans: Current law limits pension benefits to the lower of $130,000 per year or 100 percent of final average pay. H.R. 1102 would eliminate the 100 percent of pay limitation for multiemployer plans. The Chamber opposes elimination of this restriction solely for multiemployer plans, which will result in an increase in benefit beyond what was intended in collective bargaining agreements. Benefit decisions should be subject to the union-management collective bargaining process, and eliminating the 100 percent of pay restriction unilaterally increases a benefit without the opportunity to negotiate.

CONCLUSION

The U.S. Chamber of Commerce applauds the leadership of Oversight Subcommittee Chairman Houghton for holding a hearing on the state of the private pension system. With much of the focus on Social Security reform, it is imperative that the employer-sponsored retirement system not be overlooked as a key component to workers' retirement security.

We applaud Representatives Rob Portman and Ben Cardin for their leadership on this issue, and for reintroduction of comprehensive pension reform legislation. H.R. 1102 serves as a solid foundation for legislative action, and the Chamber looks forward to working with the Ways and Means Committee to move it and similar legislative proposals towards enactment.

Statement of United States Association of Importers of Textiles and Apparel, New York, NY

H.R. 984, the Caribbean and Central American Relief and Economic Stabilization Act

The U.S. Association of Importers of Textiles and Apparel strongly commends the introduction of H.R. 984 in the 106th Congress and hopes that this will finally be the year in which a practical and meaningful trade enhancement program for the Caribbean and Central American region can be achieved. The tenacity of the sponsors is truly appreciated. In the face of protectionist and self-centered proposals, H.R. 984 continues to put forward a trade enhancement program that truly would offer competitive opportunities for companies operating in the region. USA-ITA urges the Committee to promptly move forward with H.R. 984 so that the relief these countries need and deserve more than ever will be provided.

Established in 1989, USA-ITA is the largest U.S. trade association of importers of textile products. Our more than 200 members include manufacturers, distributors, retailers, and related service providers, such as shipping lines and customs brokers. USA-ITA member companies account for over $44 billion in U.S. sales annually. Many of our members source textile and apparel articles from the Caribbean and Central America.

When trade enhancement was originally proposed for the CBI, the discussion was on providing "parity" with Mexico. H.R. 984 still attempts to meet that objective, with some modifications that respond to U.S. domestic textile industry demands. The other bills proposed currently, including S. 371, the Graham bill, and the Administration's bill, would provide far less than parity for textile and apparel products. The Graham bill would provide benefits only for 807A and 809 apparel and luggage (albeit with a new definition for 807A and 809) and for knit to shape articles knit from U.S. formed yarn. The Administration bill would limit textile benefits to 807A and 809 articles (as newly defined), with the catch that existing quotas for Caribbean made products may be reduced to account for the privilege of shipping U.S. formed yarns and fabrics back to the U.S. market.

The Subcommittee should recall exactly what benefits are provided to Mexico by NAFTA. First, products that meet the NAFTA preferential rules of origin qualify for preferential duty rates, which are gradually declining to zero and some of which already are at zero. These preferential rules of origin generally require that production from the fiber or yarn stage forward occur within a NAFTA country. Therefore, as a general rule, apparel cut and sewn in Mexico from fabrics knit or woven (formed) in Mexico would qualify for NAFTA benefits. Second, since the inception of NAFTA any product cut in the U.S. from U.S. formed fabric and then assembled in Mexico is entitled to duty-free treatment. (This reflects the "traditional" definition of 807A, which seemingly has been abandoned, or rather, embellished, during the course of the prolonged debate on CBI.) All of these products also qualify for quota-free entry into the U.S. Third, NAFTA established tariff-preference levels for textile and apparel products that are Mexican under normal rules of origin (Section 334 of the Uruguay Round Agreements Act) but would not meet the more stringent

NAFTA preferential rules. Under these TPLS, annually a limited quantity of these articles are nevertheless eligible for NAFTA-equivalent benefits.

The extent to which the benefits provided to Mexico under NAFTA have worked is readily apparent from the trade statistics. Ninety-nine percent of the apparel trade from Mexico enters as NAFTA originating or under Special Regime benefits. Mexico has not become a transit point for Asian-made fabrics. See the attached tables. To the extent that TPL usage has increased in the six years since NAFTA went into effect, that is clearly a reflection of the expanding spread between the regular duty rates and the preferential duty rates, which are now at zero or close to zero as a result of a gradual phase-down period.

H.R. 984 would provide similar benefits to qualifying Caribbean and Central American producers. One difference, however, is that H.R. 984 incorporates a revised definition of 807A and 809 insisted upon by U.S. domestic industry interests. Under H.R. 984, the U.S. formed fabric also must be formed with U.S. formed yarns. Moreover, for those products both cut and assembled in a beneficiary country from U.S. formed fabric from U.S. formed yarn, the sewing must be done with U.S. formed thread. From the perspective of U.S. importers and retailers, these additional requirements create new administrative and paperwork burdens that do not currently apply to trade with Mexico.

While this aspect of H.R. 984 is disappointing, the bill is far more reasonable and acceptable than S. 371. USA-ITA is willing to accept the provisions of H.R. 984 to ensure that U.S. industry is comfortable with the incentives provided to use U.S. inputs. However, further comprise is unwarranted. The Administration bill is not only unacceptable, in at least two aspects USA-ITA believes it would violate U.S. obligations under the World Trade Organization.

S. 371 would apply benefits to only a limited number of textile products, namely 807A and 809 apparel and luggage and certain knit-to-shape articles. S. 371 does not include any benefits for apparel made from regional fabrics, other than knit fabrics made from U.S.-formed yarns, or for any textile or apparel products that meet NAFTA-equivalent preference rules. It also sloppily includes a definition of "transshipment" that would cover products for which the country of origin may not be incorrectly asserted, although a claim of preferential treatment may be. (H.R. 984 contains a correct definition of illegal transshipment and would deny benefits to those firms that improperly claim benefits under the Act.) And it would permit the President to reduce quotas by an amount equal to the three times the quantity allegedly transshipped, even if transshipment was not actually involved. Based upon reports of the Textiles Monitoring Body in Geneva, which is charged with overseeing operation of the WTO's Agreement on Textiles and Clothing, it is apparent that triple charges against quotas, even for actual illegal transshipment, is not authorized under the ATC. Therefore implementation of that provision of the Graham bill would violate U.S. obligations under the WTO.

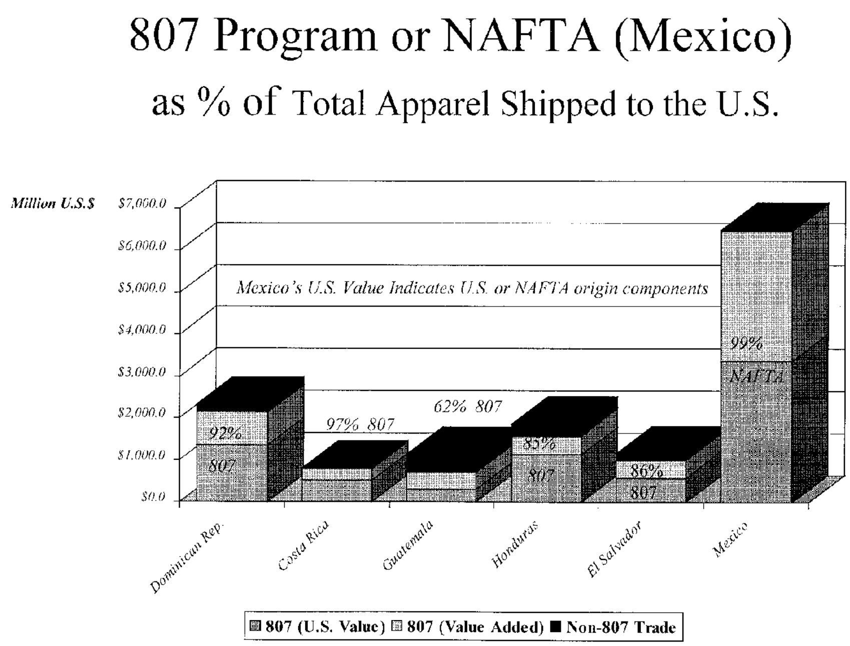
Under the Administration bill, the President would be authorized to reduce tariffs on 807A and 809 type products to zero, but also could chose to provide only a duty reduction for textile and apparel products meeting the requirements for benefits. Thus, the duty benefits offered are substantially less certain than those provided for under either H.R. 984 or S. 371. Again, like S. 371, the Administration bill creates a new definition of illegal transshipment as "falsely claiming preferential treatment" and would authorize unilateral charging of quotas in response to instances of such illegal transshipment. That aspect of the bill is in contravention with U.S. obligations under the WTO's ATC (Article 5), which requires consultations with the supplier governments and "sufficient evidence" of circumvention involving shipment through third countries before action may be taken by an importing government.

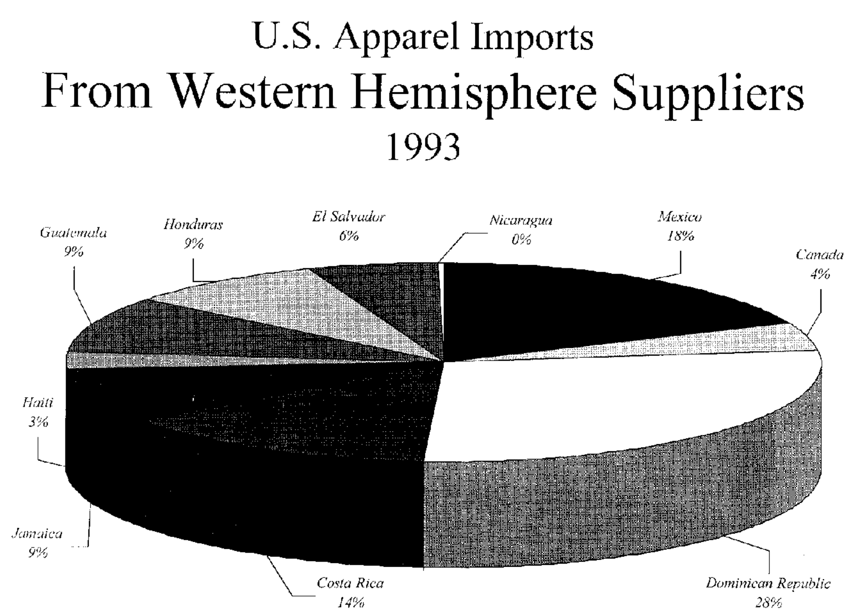
Most disconcertingly, the Administration bill also includes a provision under which the President may negotiate reductions in quota levels to account for the products that enter the U.S. quota-free under the above provisions. The ATC provides no basis for a quota level notified under the ATC (Article 2) to the TMB to be reduced, other than for specific "flexibility" provisions under administrative arrangements between importing and exporting countries. Thus, this provision of the Administration bill also violates U.S. obligations under the ATC.

USA-ITA recognizes that compromises will be necessary to enact a trade enhancement bill, but the fact is that only H.R. 984 offers benefits sufficient to ensure the development of the Caribbean and Central American region as viable sources of quality, value oriented textile and apparel products. Requirements limiting the region to using only U.S. formed fabric from U.S. formed yarn and U.S. formed thread commit the region to dependence upon U.S. mills, and limit the ability of the region to develop "full package" products that will be able to compete effectively with Mexico and with Asian suppliers in the longer term. Short-term visions restricting incentives for investment in the Caribbean and Central American region will hurt not only the region but also U.S. producers.

Respectfully submitted,

LAURA E. JONES
Executive Director

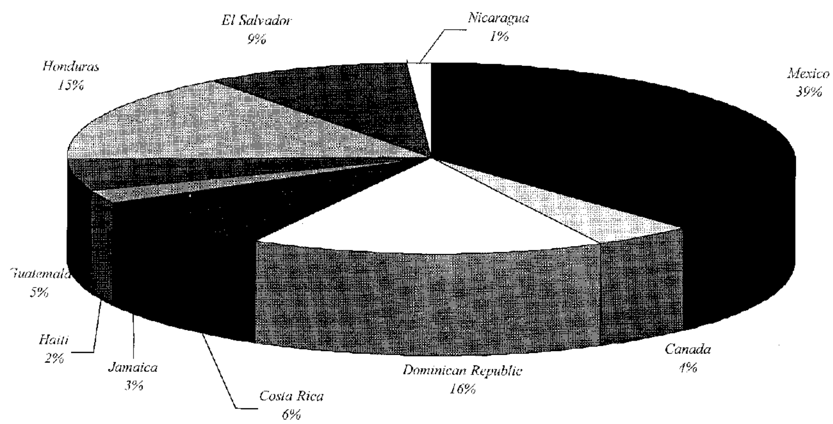




U.S. Apparel Imports

From Western Hemisphere Suppliers

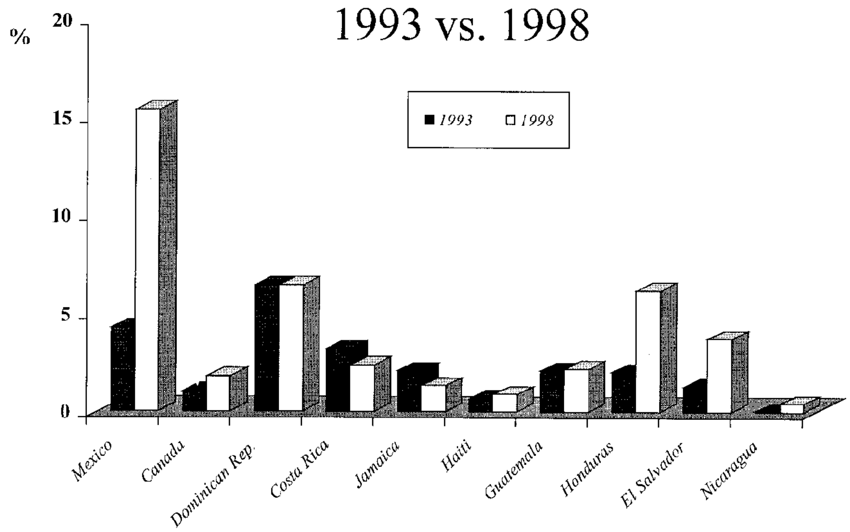
1998



CBI & Mexico Apparel Production

Percent Share of Total U.S. Imports

1993 vs. 1998



Statement of Women's Institute for a Secure Retirement

On behalf of the Women's Institute for a Secure Retirement (WISER), we would like to thank the Member of the Subcommittee for including our statement in the record. WISER, is a nonprofit organization, launched by the Teresa & H. John Heinz III Foundation. WISER's primary mission is education—partnering with a wide variety of organizations to provide women with information and retirement planning skills so that they can surmount the overwhelming challenges to securing retirement income. Our goals include increasing awareness among the general public, policy makers and the business community of the structural barriers that prevent women's adequate participation in the nation's retirement systems.

We applaud this committee for focusing on the status of the nation's retirement system and are pleased that the Committee is holding this hearing with a focus on the Comprehensive Retirement Security and Pension Reform Act of 1999 introduced by Representatives Portman and Cardin.

As a nation, the greatest pension problem we face is that tens of millions of workers are not participating in pension or savings plans or if they do have plans they are not accruing meaningful retirement benefits. A Federal Reserve Board retirement survey found that 43 percent of all families had some type of retirement plan, whether it was an individual retirement account or a 401(k) or 403(b) plan but the median value of those accounts was only $15,600.

Several important features of this bill would attempt to address this very problem.

Reform Provisions that Would Increase Plan Sponsorship

- Relief from the PGBC premiums for new small business defined benefit plans
- Elimination of IRS fees for small business plans

These provisions would remove barriers to plan creation for those employers who are most sensitive to plan administrative costs.

Reform Provisions that Would Encourage the Preservation of Retirement Income

Portability. The pension portability provisions would increase the likelihood that workers would keep the benefits that they accrue and preserve them until retirement. Allowing rollovers among all types of defined contribution retirement plans will help women who receive smaller benefits and leave their jobs more often than do men. The percentage of pension recipients receiving a lump sum benefit has greatly increased, mirroring the shift in coverage from defined benefit to defined contribution plans. Women are more likely to receive lump sum distributions than men: 63 percent compared to 44 percent. However, the distribution among for women is less than half that received by men, $5,005 for women compared to $11,373 for men. Since the data indicates that there is a strong relationship between the dollar amount of the distribution and the decision to spend the money before retirement, any mechanism that would help workers to roll over their retirement savings into another retirement plan would help to preserve the payout as retirement income.

Vesting. The provision allowing accelerated vesting for 401(k) matching contributions will also help to ensure that many more women receive benefits from their employers. Whereas many employers require five years on the job to vest in a savings or pension benefit, women have a median stay of three and a half years in their jobs. While, we would prefer to see the three-year rule extended to all pension plans, this change will clearly made a difference.

Provisions that Would not Help Lower to Moderate Income Workers

While what we have concluded here may seem controversial, it is not meant to be so. This hearing provides an opportunity to be candid when we talk about pension reforms and who these reforms are going to benefit.

Catch-up Provision. We commend the Committee for its commitment to increase the opportunities for new pension plans for all working men and women as well as finding new ways to help women by providing them with additional retirement income. Yet, we are particularly skeptical of the "catch-up" provision in the recently introduced legislation. Catch-up is heralded as a provision that would particularly benefit women. We would ask the members of the committee to look at these basic facts.

RETIREMENT CHALLENGES FOR WOMEN WORKERS

- Three out of four working women earn less than $30,000 per year.
- Half of all women work in traditionally female, relatively low paid jobs—without pensions.
- Women are more likely to work in part-time and minimum wage jobs without pensions.
- Women's earnings average $.74 for every $1 earned by men.
- Women retirees receive only half the average pension benefits that men receive.
- Women spend fifteen percent of their careers caregiving outside of the workforce compared to less than 2 percent by men.

We have provided training for thousands of women in the past decade and yet not a single one has complained that the law limits the amount of money she can put into her 401(k) savings plan or that she needs a catch-up provision to help her save. In fact, it's exactly the opposite. The majority of working women are trying to juggle their finances just to find any income to contribute to their 401(k) savings plans. They are not looking for the extra opportunity to contribute up to $15,000 in their savings plan because half of all full-time working women earn less than $22,000.

Top Heavy Rules. While "simplification" is the motivating force behind the modification of these rules, there was a reason why Congress enacted the lowered vesting requirements, namely to help secretaries and other support staff who received little from their pension plan because most of the benefits were going to the owners or company officers. We would ask that the lower vesting provisions be maintained in order to provide a minimum benefit to those who most need the benefits.

Who gets the benefits? We all know that the 401(k) savings plan has become a popular retirement benefit. But it only works well for those who can afford to contribute to their plan. We are concerned that savings plans (and pensions) are continuing to evolve into a benefit only for the highly paid. Trends and studies indicate that lower-paid workers are less likely to have access to either savings or pension plans. This raises important questions of this committee. As a nation, should we be taking a trickle-down approach to pension policy? should we be providing incentives for higher paid workers without evidence that there will be meaningful coverage for low and moderate income workers?

Last year, USA TODAY provided an analysis of the 401(k) plans of the nation's largest employers. The Special Report, "Exposing the 401(k) Gap" had a subtitle, "Those who need them most have the worst plans." We would add an additional phrase, "Those who need them most have the worst plans. . . . or have no plan at all. The study found that the worst plans are offered in the retail and service industries with the lowest matching contributions, where the workers are less likely to have pensions, the pay is low and the jobs are dominated by women.

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

We commend this Subcommittee for focusing attention on this critically important issue. The implications of inadequate pension coverage and benefit receipt are far-reaching and directly related to income. We need to address these issues now and take steps that will narrow the gap between those retirees who are financially able to save adequately without additional tax incentives and those who have lower income. People who are up against the contribution limits do not need additional help from taxpayers; why should the ordinary taxpayer end up subsidizing the wealthy to get additional tax breaks? The tax expenditures for pensions costs more in lost revenue than any other tax break—according to the Joint Committee on Taxation. We have the opportunity now to provide benefits for the average worker and we should use this opportunity.

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