EMPLOYEE AND EMPLOYER VIEWS ON RETIREMENT SECURITY

HEARING

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

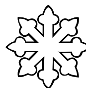
ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

MARCH 5, 2002

Serial No. 107–52

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PRINTING OFFICE

78–683 WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
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Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

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EMPLOYEE AND EMPLOYER VIEWS ON RETIREMENT SECURITY

TUESDAY, MARCH 5, 2002

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

The Subcommittee met, pursuant to notice, at 2:04 p.m., in room 1100 Longworth House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) presiding.

[The advisory and revised advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE Contact: (202) 225–7601
February 20, 2002
No. OV–9

Houghton Announces Hearing on Employee and Employer Views on Retirement Security

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 to explore the views of employees and employers on retirement security issues. **The hearing will take place on Tuesday, March 5, 2002, in room B–318 Rayburn House Office Building, beginning at 3:00 p.m.**

In view of the limited time to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for inclusion in the printed record of the hearing.

BACKGROUND:

This Subcommittee hearing will follow a February 26th hearing of the full Committee that will examine retirement security and defined contribution plans. As announced previously, the full committee hearing will focus on the rules and regulations governing pension plans, current protections for employees, the requirements imposed on employers, and recommendations to improve retirement security. The full Committee will hear testimony from the U.S. Departments of Treasury and Labor as well as pension experts.

The Oversight Subcommittee hearing will provide a further opportunity to hear comments on retirement issues, and will explore the views of plan participants and employers who offer defined contribution plans.

In announcing the hearing Chairman Houghton stated, "A retirement plan is an essential employee benefit. In the light of today's worries, the Federal Government must examine the way current rules are working. We want to hear from employees. We want to hear about the strengths and weaknesses of existing law and the proposed changes."

FOCUS OF THE HEARING:

The hearing will focus on retirement security and the current rules for retirement plans.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Due to the change in House mail policy, any person or organization wishing to submit a written statement for the printed record of the hearing should send it electronically to *hearingclerks.waysandmeans@mail.house.gov,* along with a fax copy to (202) 225–2610 by the close of business, Tuesday, March 19, 2002. Those filing written statements who wish to have their statements distributed to the press and interested public at the hearing should deliver their 200 copies to the Subcommittee on Oversight in room 1136 Longworth House Office Building, in an open and searchable package 48 hours before the hearing. The U.S. Capitol police will refuse messenger deliveries to all House Office buildings.

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. Due to the change in House mail policy, all statements and any accompanying exhibits for printing must be submitted electronically to *hearingclerks.waysandmeans@mail.house.gov,* along with a fax copy to (202) 225–2610, in WordPerfect or MS Word format and MUST 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.

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

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.

*** * * NOTICE—CHANGE IN TIME AND LOCATION * * ***

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE — Contact: (202) 225–7601
February 26, 2002
No. OV–9-Revised

Change in Location for Subcommittee Hearing on Employee and Employer Views on Retirement Security

Congressman Amo Houghton, (R–NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee hearing on employee and employer views on retirement security, scheduled for Tuesday, March 5, 2002, at 3:00 p.m., in room B–318 Rayburn House Office Building, **will now be held at 2:00 p.m. in the main Committee hearing room, 1100 Longworth House Office Building.**

All other details for the hearing remain the same. (See Subcommittee Advisory No. OV–9 released on February 20, 2002.)

Chairman HOUGHTON. Good afternoon, ladies and gentlemen. Thanks very much for attending this hearing, and we certainly appreciate you gentlemen being willing to testify here.

Congress, as you know, has paid a great deal of attention in recent months to the need to provide for increased security for retirement benefits. While we cannot pass legislation to prevent the normal business cycles that inevitably produce company failures, we

can examine how to help workers build a solid foundation for their retirement years.

A retirement plan is an essential employee benefit. In light of today's worries, the Federal Government must examine the way current rules are working. We want to hear from employees. We want to hear about the strengths and weaknesses of existing law and the proposed changes.

The problems raised by the Enron situation are a wake-up call that now has everyone's attention, but we should not dwell on the actions of one failed company. We need to get a wider perspective and legislate on the collective needs of workers and companies. So today's hearing really is not about Enron but rather about the security of retirement funds.

Employers and employees have a variety of options to help assure a comfortable retirement. Social Security, defined benefit (DB) plans, defined contribution plans, employee stock option, and ownership plans—I am sure you all know these very well—individual savings accounts. Different plans come with different options and, of course, different rules. But it is the variety of retirement options that should be helpful to employees and employers.

Just as the one size does not fit all when it comes to a suit of clothes, no single pension plan will best fit every employee. Younger employees may have less money to contribute but prefer to assume more risk. Conservative investors or those near retirement age should have conservative options. Employees with outside retirement assets may prefer to concentrate their company retirement funds in a single asset. Large companies may be able to offer many plans, while small employers need to have simple plans with simple rules.

So today's hearing follows a hearing held by the full Committee last week. That hearing reviewed the recommendations made by the administration and the views of several outside experts. So today, we will hear from employers and employees and hear what works and what can be improved and where changes might produce more harm than good.

Now I am pleased to yield to my colleague, Mr. Coyne.

[The opening statement of Chairman Houghton follows:]

Opening Statement of the Hon. Amo Houghton, a Representative in Congress from the State of New York, and Chairman, Subcommittee on Oversight

Good afternoon. Congress has paid a great deal of attention in recent months to the need to provide for increased security of retirement benefits. While we can't pass legislation to prevent the normal business cycles that inevitably produce company failures, we can examine how to help workers build a solid foundation for their retirement years.

A retirement plan is an essential employee benefit. In light of today's worries, the Federal Government must examine the way current rules are working. We want to hear from employees. We want to hear about the strengths and weaknesses of existing law and the proposed changes.

The problems raised by the Enron situation are a wake up call that now has everyone's attention. But we should not dwell on the actions of one failed company—we need to get a wider perspective and legislate on the collective needs of workers and companies.

So today's hearing is not about Enron, but rather about the security of retirement plans. Employers and employees have a variety of options to help assure a comfortable retirement. Social Security. Defined benefit plans. Defined contribution

plans. Employee stock ownership plans. Individual savings accounts. Different plans come with different options and different rules.

But it is the variety of retirement options that should be helpful to employees and employers. Just as "one size DOES NOT fit all" when it comes to a suit of clothes, no single pension plan will fit best for every employee. Younger employees may have less money to contribute, but prefer to assume more risk. Conservative investors or those near retirement age should have conservative options. Employees with outside retirement assets may prefer to concentrate their company retirement funds in a single asset. Large companies may be able to offer many plans while small employers need to have simple plans, with simple rules.

Today's hearing follows a hearing held by the full committee last week. That hearing reviewed the recommendations made by the Administration and the views of several outside experts. Today we will hear from employers and employees—hear what works, what can be improved, and where changes might produce more harm than good.

I'm pleased to yield to my colleague, Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. I want to thank Chairman Houghton for scheduling today's hearing on overall pension issues under the Committee's jurisdiction. Retirement security in America is one of the most important issues under the Ways and Means Committee's jurisdiction. About 100 million workers participate in employer-sponsored pension and retirement savings plans and they rely on these plans for their retirement security. Together, these pension plans account for more than $4 trillion in retirement assets.

The financial collapse of Enron had a devastating impact on the workers and retirees at Enron. I believe that the testimony of the several former Enron employees about how the bankruptcy of their employer has left them largely pensionless will prove useful in reminding Members of Congress of the high stakes associated with decisions that we make on these issues.

Some of the questions we must ask today are, should company stock be used as the employer match in funding a worker's pension plan? Should pension investment lockdowns or freezes be allowed for lengthy periods of time and not apply equally to all employees? What issues do employees face in saving for their retirement through employer-provided 401(k), thrift saving, profit sharing, and employee stock ownership plans? What types of plans and investments and information should employees have to ensure that they have adequate pension benefits when they retire?

As we learn from the Enron experience today, I hope we can consider and that we will consider the risks involved in the privatization of Social Security. It is my concern that privatization of Social Security would unnecessarily put workers' pension assets at great risk. Congress must be careful in considering new pension legislation to respond to any shortfalls brought to light by the Enron collapse while at the same time being mindful of the fact that the biggest pension problem in the United States today is the lack of pension coverage for more than half of all workers in our workforce.

I look forward to hearing from all of the witnesses about these issues, including what this Committee can do to prevent Enrons in the future. Thank you, Mr. Chairman.

[The opening statements of Mr. Coyne and Mr. Foley follow:]

Opening Statement of the Hon. William J. Coyne, a Representative in Congress from the State of Pennsylvania

I want to thank Subcommittee Chairman Houghton for scheduling today's hearing on overall pension issues under the Committee's jurisdiction. Retirement security in America is one of the most important issues under the Ways and Means Committee's jurisdiction. About 100 million workers participate in employer-sponsored pension and retirement savings plans, and they correctly rely on these plans for their retirement security. Together, these workers' pension plans account for more than $4 trillion in retirement assets.

The financial collapse of Enron had a devastating impact on the company's workers and retirees. I believe that the testimony of several former Enron employees about how the bankruptcy of their employer has left them largely pensionless will prove useful in reminding Members of the Committee of the high stakes associated with the decisions we make on these issues.

Some of questions which we must ask today are:

- Should company stock be used as the "employer match" in funding a worker's pension plan?
- Should pension investment lockdowns or freezes be allowed for lengthy periods of time and not apply equally to all employees?
- What risk issues do employees face in saving for their retirement through employer-provided 401(k), thrift saving, profit sharing and employee stock ownership plans?
- What types of plan and investment information should employees have to ensure they have adequate pension benefits when they retire?

As we learn from the "Enron experience" today, I hope the Subcommittee will consider the risks involved in the privatization of Social Security. It is my concern that privatization of Social Security would unnecessarily put workers' pension assets at great risk.

Congress must be careful in considering new pension legislation to respond to any shortfalls brought to light by the Enron collapse—while at the same time being mindful of the fact that the biggest pension problem in the United States today is the lack of pension coverage for more than half of all workers.

I look forward to hearing from all the witnesses about these issues, including what this Committee can do to prevent "Enrons in the future."

Thank you.

Opening Statement of the Hon. Mark Foley, a Representative in Congress from the State of Florida

Good afternoon Mr. Chairman. I want to thank you for holding these hearings today on this very important issue—employee retirement plans. After the collapse of Enron and the Chapter 11 filing of K-Mart, we in Congress were forced to look at the way employee retirement accounts are created, managed and invested.

Year after year thousands of employees invest billions of dollars in employee retirement accounts. Many of these accounts allow for 100% investment of an employees fund into the parent company. For many of these employees, most of whom are not financial advisors or have any investment background, they invest without any guidance by a professional. For some, this has led to a dangerous trend of relying on the earnings and growth of only one company—and has we have seen in the past few months can falter for even one of the top Fortune 500 companies.

Mr. Chairman, as we proceed in this subcommittee in investigating this matter, we must be careful in balancing our approach. We must continue to allow individual investors to manage their accounts as they wish, while protecting those with little or no experience in this area from unscrupulous practices of their company leadership. Mr. Chairman, I believe we can attain such a balance if companies provide the investor with the appropriate knowledge to make the right choices. We must require businesses to provide adequate and regular information to employees about their retirement accounts so that they, and not the government, make the appropriate choices for themselves. Last November, the House took action on this issue when it passed H.R. 2269, the Retirement Security Advice Act of 2001. However, to date, the Senate has yet to take any action on this very important piece of legislation—which is placing thousands of employees at continued risk.

Mr. Chairman, I believe that providing information to the investor is just the first step. We must begin to look at all aspects of these accounts by reviewing current holding periods, blackout periods, and diversification matters. Again, Mr. Chairman,

I applaud your efforts in holding these hearings as we consider legislative corrections to the current crisis.

Chairman HOUGHTON. Thanks very much, Mr. Coyne.

I would like to call the first panel. Let me just introduce you first so everybody understands who you are. James Klein, who is President of the American Benefits Council. We are delighted to have you here, Mr. Klein. Scott Macey, Senior Vice President of AON Consulting, Somerset, New Jersey. He is on the Board of Directors of the ERISA Industry Committee. It is nice to have you here. Gene Little, Senior Vice President, Finance, Timken Company in Canton, Ohio. And Craig Hoffman, President of the American Society of Pension Actuaries, and Vice President and General Counsel of SunGard Corbel of Jacksonville, Florida. Thanks very much for being here.

Mr. Klein, would you like to start your testimony?

STATEMENT OF JAMES A. KLEIN, PRESIDENT, AMERICAN BENEFITS COUNCIL

Mr. KLEIN. Thank you, Mr. Chairman. The American Benefits Council represents Fortune 500 companies and others who are involved in providing services to retirement and health plans that cover more than 100 million Americans. We certainly appreciate, Mr. Chairman, your leadership on issues related to stock ownership programs and it is a pleasure to be here before you and the other Members of the Subcommittee.

One cannot help but listen to the compelling testimony from Enron employees in recent months and not be determined to take steps to prevent such a situation from occurring again. But I really think that your task is extremely difficult. You really need to respond to the legitimate concerns that have been raised and help prevent future Enrons without undermining the 401(k) and employee stock ownership plans that have allowed 56 million Americans to accumulate some $2.5 trillion of retirement savings.

Unfortunately, since the demise of Enron, there have been so many myths and misunderstandings about 401(k) plans that have been portrayed in the media and elsewhere, and I am very pleased, Mr. Chairman, that you specifically said that this is not a hearing about Enron but about the system as a whole because I think that is really the right approach.

Given all of that, I really thought that the best service that I might provide to the Subcommittee would be to use my 5 minutes to identify just three of the most prominent myths and misunderstandings and highlight some issues that I think have really been lost in all of the noise surrounding Enron.

Myth number one is that employees are too heavily invested in their own company stock and not sufficiently diversified. Undeniably, some plans that have company stock as either the employer's match or the employee's investment choice or both have a very high level of total plan assets in company stock. But it does not automatically follow that the participants in these plans are at risk or that they are poorly diversified.

Whether a person is adequately diversified really depends on a number of situations and on their overall investment portfolio, not

just their 401(k) plans. The fact remains that one worker who is, let us say, 50 percent—has 50 percent of his or her 401(k) plan in company stock, or any other single investment, for that matter, might, in fact, be better diversified overall than another worker who has just 10 percent invested in company stock, and that is really just one reason why we think that the proposals that would impose a rigid cap on the percent of a 401(k) plan that could be invested in company stock are both unwise and really unfair to workers.

Moreover, virtually no one in Congress or in the media has focused on the fact that the overwhelming number of workers whose 401(k) plans include company stock also participate in the traditional defined benefit pension plan that is funded by the employer and whose benefits are guaranteed by the Federal Government. Now, I do not point this out to diminish in any way the seriousness of 401(k) losses, but I think it is important to keep in mind that roughly three-quarters of the working population does not participate at all in a traditional pension plan.

So I think it is reasonable for this Subcommittee to question whether a pension should be primarily focused on building upon the successes of the Portman-Cardin legislation of last year and seeking ways to provide more traditional pension plan coverage for many working Americans rather than focusing just on the much smaller number of 401(k) plan participants who are invested in company stock when the overwhelming majority of them are also protected by Federally guaranteed defined benefit pension plans.

In this regard, I think that we think one of the best things that Congress can do to promote retirement security would be to pass the legislation that I know Congressmen Portman and Johnson and Pomeroy and Cardin are planning to introduce later this week to reform the interest rate required to be used for traditional pension plan funding in order to save this vital component of the retirement security system.

The second myth is that a heavy concentration of 401(k) investment in company stock is due to company contributions that are subject to employer-imposed holding periods and that, therefore, more immediate diversification rights are needed. In fact, a recent World at Work survey found that about 56 percent of employers require workers to hold company stock contributions for some period of time.

Enron was one such company. It has a required holding period until workers reached age 50. But even there, fully 89 percent of Enron's stock in the 401(k) plan was not subject to the age 50 holding period but could be traded into any number of the other 20 investment options that were available at any time.

One reason that these holding periods in 401(k) plans are important for both employers and employees is that if employers are prevented from requiring them, some companies, not all, but some companies might understandably direct resources into other stock ownership programs where the company can require holding periods. While these other types of programs are certainly valuable, this response certainly could have negative implications for retirement security.

Last, myth number three, and that is that so-called blackout periods when 401(k) plan transactions are suspended but they are manipulated somehow by employers so that there needs to be a maximum duration for such blackouts and that liability should be imposed on employers if there are investment losses during these blackout periods. The fact is that temporary blackout periods are a normal part of plan administration. Transaction suspensions occur for a number of completely legitimate reasons, usually having to do with a change in plan administrators or investment choices.

We think that sufficient advance notice of blackout periods is a good idea and we support legislation that would require it. But if Congress imposes a maximum duration on blackouts or holds employers liable for a decline in asset value during these blackout periods, it will harm the very people you want to help. Employers and employees can have no tolerance for any mistakes occurring when a plan changeover takes place. But if you impose arbitrary time limits on transaction suspension, inevitably, such mistakes will occur and there will not be sufficient time to ensure that they are corrected.

And on a final, and I would say very personal, note, I would say that as the person in my own organization who assumes fiduciary responsibility for administering the plans that cover my colleagues, I can attest to the fact that some employers will certainly refrain from making plan improvements if, as a result of new legal causes of action, employers would now be subjected to new liability for possible investment losses during a necessary blackout period. This would clearly be a case of no good deed goes unpunished.

ERISA imposes extraordinarily high standards on those of us who are plan fiduciaries, and appropriately so. We can be held personally liable for both civil and criminal violations. Current laws should be vigorously enforced. In the Enron situation, for example, if some of the allegations that have been made are proven, there may be all sorts of liability under Federal and State law for misdeeds, but new ERISA causes of action of the kind being proposed really could have a chilling effect on plan sponsorship and innovation.

I thank you for the opportunity to be here and I would be, of course, pleased to answer questions on these or any other matters.

[The prepared statement of Mr. Klein follows:]

Statement of James A. Klein, President, American Benefits Council

Good morning, Chairman Houghton, Ranking Member Coyne and members of the Subcommittee, and thank you for the opportunity to appear this morning. I am James Klein, president of the American Benefits Council, which is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement, stock and health plans covering more than 100 million Americans.

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

Let me begin, Mr. Chairman, by sharing the Council's perspective on our nation's 401(k) and employee ownership system. Today more than 42 million Americans participate in 401(k) plans and 14 million more participate in profit-sharing and employee stock ownership plans (ESOPs). These 56 million workers have accumulated more than $2.5 trillion in retirement savings and many have built a substantial ownership stake in their company. These successful employer-sponsored plans not only prepare workers for retirement and democratize corporate ownership, but also

serve as an engine of economic growth by providing one of our nation's most significant sources of investment capital. Congress has, over many decades, promoted these retirement savings and employee ownership plans through tax and other incentives,[1] with very positive results for tens of millions of American workers.

American Benefits Council member companies make frequent use of employer stock in both 401(k) and employee stock ownership plans (ESOPs). Many of our members provide their 401(k) match in the form of company stock[2] and those that do not typically make company stock available as one of the diverse menu of 401(k) investment options they provide to their employees.[3] A number also sponsor standalone ESOPs as a supplement to their 401(k) and other retirement programs.

While some of our members allow employer stock contributions made to a 401(k) plan or an ESOP to be diversified immediately, many others impose a holding period on how long employer contributions made in the form of company stock must remain in that stock.[4] These holding periods typically end when an employee reaches a certain age, such as 45 or 50, or when the employee departs the company.[5] Companies impose these holding periods because they want to create a long-term ownership stake on the part of employees. Needless to say, many employees have enjoyed tremendous investment returns as a result of this investment in company stock.[6] It is this positive investment performance of employer stock, together with employee preference for this investment option, that can result in a substantial percentage of a company's 401(k) plan assets being invested in employer securities. The idea that this concentration in employer stock is due largely to employer contributions subject to holding periods is simply not accurate.[7]

Why do Council members make use of employer stock in their retirement plans? Because in many instances the employees of our member organizations, who want to share in the success of their companies, have asked their employers to do so. And Council members have responded favorably because they believe that providing employees with the opportunity to invest in the company creates a culture of ownership and accountability that promotes productivity and employment stability.[8] At the same time, however, Council member companies take the principle of diversification in retirement savings very seriously and make it a regular part of their communications to 401(k) participants.

Nearly all Council members also sponsor a defined benefit pension plan to help their employees build retirement security with a guaranteed, employer-funded benefit. Indeed, maintenance of a diversified defined benefit pension is typical of employers that provide a 401(k) match in company stock or that offer company stock as a 401(k) plan investment option.[9] Given this diversified and government-insured

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

[2] Researchers have estimated that less than 1% of 401(k) plans provide a match in company stock. Since plans that do so are typically sponsored by large employers, however, these plans cover 6% of the nation's 401(k) plan participants. See Jack VanDerhei and Sarah Holden, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2000," Employee Benefit Research Institute Issue Brief, November 2001.

[3] The typical Council member offers at least a dozen 401(k) plan investment choices to its employees. These generally include a range of diversified stock and bond mutual funds.

[4] A recent survey of employers with company stock in their 401(k) plans indicated that 56% require employees to hold the contributions made in stock for some period of time. See WorldatWork Survey on 401(k) Plans and Company Stock, January 2002, www.worldatwork.org.

[5] The same survey revealed that of those employers imposing holding periods, 51% did so until a particular age, 30% did so until the employee departs from the company and 19% did so until the employee reached a given length of service with the company. See WorldatWork Survey on 401(k) Plans and Company Stock, January 2002, www.worldatwork.org.

[6] Even during the recent years of depressed stock market returns, the share price of many companies that include stock within their retirement plans has risen substantially. From December 1998 through November 2001, the stock of Target rose 66.2%, the stock of Anheuser-Busch rose 41.3% and the stock of Home Depot rose 38.2%. Each of these companies includes substantial employer stock within its 401(k) plan. See IOMA's DC Plan Investing, December 11, 2001.

[7] Indeed, even in the case of Enron, 89% of the Enron stock held in the 401(k) plan was not subject to the age 50 holding period imposed by the company but could be traded into other of the plan's 20 investment options at any time. See Leigh Strope, "401(k) Plan Losing Steam in Congress," Associated Press, February 27, 2002.

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

[9] "About 75–75% of participants in plans that are heavily invested in employer stock are in companies that also maintain diversified pension plans, indicating that [defined contribution

foundation, the retirement security of workers who have a 401(k) plan with a company stock feature should not be regarded as unduly at risk. The tens of millions of American workers who lack access to any retirement plan at all at their place of work are certainly at least, if not more, deserving of Congress' attention and concern.

As Congress evaluates the appropriate retirement policy response to the Enron bankruptcy, we at the Council urge you to keep the employer-sponsored system's success squarely in mind and hold true to the long and bipartisan congressional support for our nation's voluntary retirement savings and employee ownership system.

The Appropriate Response: Information, Education and Professional Advice

Mr. Chairman, one cannot hear of the experiences of Enron employees and not be determined to take steps to prevent such a situation from occurring in the future. At the same time, one cannot examine the realities of the 401(k) system without concluding that overly aggressive legislative change could unintentionally harm the very people that Congress hopes to protect. Chairman Houghton, you and the members of this Subcommittee understand the delicate balance of regulation and incentives upon which the success of our voluntary, employer-sponsored pension system depends. We ask that you keep this delicate balance at the center of your deliberations as you lead this Committee's response to the Enron bankruptcy.

In order to avoid unintended harm, the Council believes that retirement policy responses to Enron should focus on ensuring that 401(k) participants have the information, education and professional advice they need to wisely exercise their investment responsibility. To this end, we support the proposals contained in the Employee Retirement Savings Bill of Rights put forward by Representatives Rob Portman (R–OH) and Ben Cardin (D–MD) (H.R. 3669) and in the Pension Security Act put forward by Representatives John Boehner (R–OH) and Sam Johnson (R–TX), to provide employees with advance notice of transaction suspension periods as well as periodic notices that stress the importance of diversification. The Council likewise supports the provision of H.R. 3669 that will allow employees to save for the cost of retirement planning services on a pre-tax basis through payroll deduction at the workplace.

The Council further believes that enactment of Representative John Boehner's Retirement Security Advice Act (H.R. 2269), which the House of Representatives approved last fall, should be a key component of the congressional response to Enron. This legislation will help many more 401(k) plan participants get the professional investment advice they desire by clarifying employer obligations and opening up the advice marketplace to a greater number of competitors. We are pleased that the Bush Administration has made the Retirement Security Advice Act a central part of its 401(k) reform package and that Representatives Boehner and Johnson have included this measure in their recent legislation (H.R. 3762).

While the Portman/Cardin and Boehner/Johnson bills reflect very careful thought and contain a number of reforms we support, we hope to work with the bill's sponsors to address certain concerns. In particular, the Council looks forward to a continued dialogue on regulation of the holding periods sometimes imposed by employers on the sale of company stock they contribute to retirement plans. We are concerned that overly strict limits on these holding periods could risk reduced matching contributions in some circumstances since employers will no longer be able to guarantee that every worker has a long-term ownership stake. In particular, such changes may lead employers to divert resources from 401(k) programs into broad-based stock option programs, where the company can guarantee that employees will maintain an ownership interest. As a general matter, we believe that the earlier in a worker's career that he or she is permitted to sell company shares and the greater the percentage of shares the employee may sell, the greater the risk that some employers will reduce their matching contributions. Consequently, we would urge you to continue to permit employers to require that some portion of employer contributions made in company stock remain in that stock.

We also have very significant concerns about the Bush Administration's proposal for heightened fiduciary liability during transaction suspension periods. Specifically, that proposal would make plan fiduciaries responsible for the prudence of plan par-

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plans with investment in employer stock] tend to supplement rather than substitute for diversified plans." Douglas Kruse, Testimony before the Employer-Employee Relations Subcommittee, House Education and the Workforce Committee, February 13, 2002.

ticipants' investments during suspension periods.[10] First of all, it is absolutely clear under current law that employers maintain their fiduciary duty to act prudently and solely in the interest of participants both when initiating transaction suspension periods and during such periods. No change in law is needed to achieve this result. The only protection granted to employers in this area under current law is that they are not responsible for the performance and prudence of employees' investment choices when employees make these investment choices themselves. This protection has been absolutely critical to the growth of 401(k) and other defined contribution plans in recent decades.

By denying this protection during transaction suspension periods, the Administration's proposal would result in a requirement that employers "second-guess" employees' plan investment choices and would make employers liable for employees' imprudent investments. It is not clear what an employer should do during a suspension period to satisfy this new obligation. Should it override the employees' investment choices and move their account balances into different investments? Should it sell billions of dollars in company stock, driving the stock price lower and infuriating employees and other shareholders? The Council believes that there is simply no reasonable course for an employer to take in response to the new obligations this proposal would impose. If clarification of employers' existing fiduciary duties during suspension periods is necessary, then the Department of Labor should issue additional guidance. But imposition of a vast new responsibility for the prudence and performance of employees' investment selections will deter employers from initiating retirement plans and will drive existing plan sponsors from the system. We strongly urge you to reject the proposed legislative changes in this area.

Percentage Caps on Company Stock Would Harm Employees

The Council also strongly urges Congress to reject percentage caps on the amount of an employee's 401(k) account that could be invested in company stock. These caps, which are included in a number of bills (H.R. 3463, H.R. 3640, H.R. 3677, S. 1838), would be unpopular with—and contrary to the best interests of—the many employees who benefit from having an ownership stake in their company. Indeed, recent research has shown that 401(k) investment returns for workers would be 4 to 8% lower were company stock removed from these plans.[11] Moreover, Congress simply cannot know how much investment in employer stock is appropriate for each 401(k) participant. This decision depends upon a myriad of personal variables—a worker's age and planned retirement date, traditional pension coverage or lack thereof, the existence of retirement savings from prior jobs or non-workplace savings, the pension situation of a spouse, etc. Given this reality, Congress should not substitute its judgment for that of the individual. Rather than limiting employee opportunity through the imposition of caps, we believe Congress should empower workers to wisely exercise their freedom of choice through provision of the new informational and educational tools discussed above.

Percentage caps would also prevent employers from continuing to provide 401(k) matching contributions in stock. Under a typical 401(k) matching formula, employers provide a 50% match on employee contributions up to a certain percentage of pay, often 6%. Thus, for every dollar of employee savings, the employer contributes 50 cents in stock. For the typical worker this would produce an account that is 33% invested in employer stock, which would automatically violate the 20% ceiling contained in the leading cap proposals. Unable to achieve their purpose of providing an ownership stake to employees via the stock match—and given the greater expense of matching in cash—many employers may respond to caps by reducing their matching contributions. The unfortunate result will be *fewer* employer match dollars contributed to employee accounts. This will weaken one of the most effective incentives for employee saving[12] and inadvertently harm the very people Congress wishes to protect.

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[10] This would remove the protection granted under the law today by ERISA Section 404(c), under which a plan fiduciary is not responsible for the prudence of, and returns on, a participant's plan investments if the participant controls his or her own investments.

[11] Under a recent simulation performed by Professor Jack VanDerhei of Temple University, the investment returns in 401(k) plans that included company stock were 4 to 7.8 percent higher than in plans without company stock. See Jack L. VanDerhei, Testimony before the Employer-Employee Relations Subcommittee, House Education and the Workforce Committee, February 13, 2002.

[12] See Jack VanderHei and Craig Copeland, "A Behavioral Model for Predicting Employee Contributions to 401(k) Plans," *North American Actuarial Journal* (First Quarter, 2001).

Transaction Suspension Periods Are Normal and Necessary

Some of the retirement bills introduced in response to the Enron bankruptcy, such as those from Representatives George Miller (D–CA) (H.R. 3657) and Ken Bentsen (D–TX) (H.R. 3509), seek to cap the length of (or otherwise restrict) transaction suspension periods. These are periods during which employees are unable to make investment changes in their 401(k) accounts. Yet transaction suspension periods, which typically accompany a change in 401(k) record-keeper or the inclusion of an acquired firm's employees in a company's plan, are a normal and necessary part of 401(k) plan administration. In fact, the plan changes that require such suspensions are often undertaken to improve the services or investment options offered to employees. While we certainly understand the desire to minimize the length of these periods, a fixed time limit is simply not practical, nor is it in the best interests of the plan's participants.

The length of the transaction suspension period is highly dependent on factors such as the quality of the participant data, the sophistication and compatibility of the computer systems and programs involved, the number of plan participants and the number of plan loans outstanding. Furthermore, individuals' account information and investment selections must be correct when the transaction is complete, with neither employers nor employees tolerant of mistakes. I can assure you that employers seek to minimize the length of suspension periods, and such periods are declining due to competition among 401(k) providers. Yet employers and providers will not always be able to meet fixed time limits and attempting to do so will lead to mistakes. Simply stated, employers have no rational reason to extend transaction suspension periods any longer than the time needed to properly and accurately conclude the administrative matters prompting the need for the suspension. Sufficient advance notice of transaction suspension periods, as required under the Portman/Cardin and Boehner/Johnson bills, is a good idea and will ensure that 401(k) participants are well served. But arbitrary limits on how long such a suspension period may last is a classic example of a well-intentioned idea that will harm the very people it is designed to protect.

Radical Restructuring of the 401(k) System is the Wrong Response to Enron

Even beyond the issue of limits on transaction suspension periods, we are gravely concerned about the Miller legislation (H.R. 3657) because, unlike the Portman/Cardin bill (H.R. 3669), it does not advance targeted responses to the specific issues raised by Enron but rather seeks to make wide-ranging and fundamental changes to our nation's defined contribution plan retirement system. The bill would radically change ERISA's enforcement mechanism by creating vast new categories of defendants and damages applicable to ERISA claims (even those beyond the pension arena), fundamentally alter the retirement plan governance system by requiring joint trusteeship, and substantially reduce the vesting schedule for employer contributions.

Vast new remedies will increase litigation and costs, joint trusteeship will increase workplace conflict and hamper plan administration, and reduced vesting will lower employer contributions. Under such a regime, many employers will question whether it makes any sense to retain their voluntary retirement plan offerings, and businesses not yet in the system will be deterred from ever starting a plan. The unfortunate result will be fewer employees with retirement plan coverage.

Such steps are particularly unwarranted given that Congress, just last year, engaged in a thorough review of the 401(k) system before passing important 401(k) plan improvements included in the Economic Growth and Tax Relief Reconciliation Act of 2001. While the broad tax bill did not enjoy substantial bipartisan support, the Portman/Cardin 401(k) and pension reforms it contained enjoyed wide bipartisan co-sponsorship and passed the House of Representatives repeatedly with more than 400 votes. With this legislation, Congress wisely sought to build on the success of the 401(k) system and expand the number of employees with access to 401(k) plans. The important reforms enacted last year should be given time to work and Congress should not now head in a completely different direction based on the unfortunate developments at a single company.

Time for a Renewed Congressional Commitment to Defined Benefit Plans

In one potentially fortunate development, the losses suffered by Enron 401(k) participants have renewed interest in defined benefit pension plans. These types of plans, which are funded by the employer and insured by the Federal Government, make an effective complement to a 401(k) program. Yet the number of these plans continues to decline, from a high of 175,000 in 1983 to fewer than 50,000 today. This decline is partly attributable to over-regulation by Congress and its attendant costs and complexities. We believe Congress should now use the occasion of its

Enron review to streamline the rules that apply to defined benefit pensions so that more companies can provide these employer-funded and insured benefits to their workers.

Representatives Portman, Johnson, Cardin and Pomeroy have led the way in addressing one of the most vexing problems faced today by defined benefit plan sponsors—the inflated liabilities, funding requirements and premium obligations that have resulted from the buyback and discontinuation of the 30-year Treasury bond. As you know, rates on 30-year bonds have fallen to historic lows as these bonds have become scarcer. Yet our pension laws require the 30-year rate to be used to calculate pension plan liabilities. The result has been to artificially inflate these liabilities by 15 to 25 percent, forcing many employers to make huge and unwarranted pension contributions in the midst of an economic downturn. Representatives Portman, Johnson, Cardin and Pomeroy were instrumental in including relief from these unwarranted obligations in the House-passed economic stimulus legislation (H.R. 3529) and we are pleased that they will be introducing bipartisan legislation this week to provide the necessary pension interest rate relief. With enactment of this urgently-needed measure, Congress can move quickly to shore up the defined benefit pension system, preventing additional employers from abandoning these guaranteed plans that effectively advance workers' retirement security.

The decline in our nation's defined benefit system also offers a sobering lesson about the dangers of overreacting to the Enron bankruptcy with over-regulation. The Council believes strongly that Congress must approach any new regulation of 401(k) plans with extreme caution so as not to produce the same disastrous decline in employer sponsorship of 401(k) plans that we have seen in the traditional pension arena.

Conclusion

In closing, Mr. Chairman, the Council urges a cautious and prudent retirement policy response to the Enron collapse so as not to undermine our successful retirement savings and employee ownership system. Information and advice—rather than restricted choice, over-regulation and broad new liabilities—are the strategies that will protect workers and retirees while fostering the continued growth of the private, employer-sponsored retirement system.

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

Chairman HOUGHTON. Thanks very much. The only admonition I would make is if you could try to keep your testimony within the 5-minute period, it sure would help. Thanks very much. Mr. Macey?

STATEMENT OF SCOTT J. MACEY, SENIOR VICE PRESIDENT, AON CONSULTING, SOMERSET, NEW JERSEY, AND MEMBER, BOARD OF DIRECTORS, ERISA INDUSTRY COMMITTEE

Mr. MACEY. Good afternoon, Mr. Chairman and Members of the Subcommittee. I am here today on behalf of the ERISA Industry Committee (ERIC).

At the outset, I would like to certainly commend the Chairman for introducing H.R. 2695, which clarifies the tax treatment of statutory stock options. We would be pleased to continue to work with the Chairman to secure its prompt enactment.

Although we understand fully the interest in ERISA and employee benefits at today's hearing, we believe that, first and foremost, these are matters of corporate governance, full disclosure, and accounting standards, and we, too, agree with the Chairman's comment not to focus solely on the actions or experience of one company.

I would like to turn now to a number of pending proposals to impose new restrictions on individual account plans. These bills propose matters such as the imposition of caps on holding employer shares, new diversification requirements, joint trusteeship, loss of

tax deductibility, restrictions on administrative blackout periods, and other new rules or restrictions.

First, before imposing new restrictions on the investments made by individual account plans and imposing other requirements or limitations on such plans, Congress should carefully consider what the consequences are likely to be. Increasingly onerous regulation of defined benefit plans during the eighties had devastating effects on the willingness of employers to maintain those plans. Before imposing new restrictions on individual account plans, Congress should consider how employers are likely to respond to any such new restrictions.

Congress should allow employees to continue to make their own decisions regarding the investment of their participant-directed accounts. Congress should not impose caps on employees' investment in employer stock. Employees place great value on the freedom to make their own investment choices. Congress should not abridge that freedom.

In fact, millions of American workers have achieved significant financial security through successful investments in their employers' shares. Congress should allow stock-based plans to achieve their objective of aligning the interest of employees with the interests of employers' business.

In light of the Enron matter, however, it may be appropriate for Congress to amend the law to give employees greater rights to diversify the investment of employer contributions in their individual accounts. However, the substance and timing of any such new rights should carefully balance the interest of employers and employees.

The challenge facing Congress is to strike the correct balance between diversification and the objectives of a stock-based program. Although it is difficult to state with certainty just how and where to strike that balance, there are a number of possible alternatives that merit consideration. Some of these include allowing one or more of the following: Alternative diversification schedules for different types of plans or different plans, a class year approach, differentiating between different types of contributions, and differentiating between different types of plans and plan designs. I have addressed some of these suggestions in more detail in my written submission.

Congress should carefully address the transition and effective date issues raised by the pending bills. Many stock-based plans have been around for decades. They hold substantial blocks of employer stock. If new employer stock rules go into effect immediately with respect to existing accounts, without adequate transition or phase-in, this will likely result in adverse market reactions and significant losses for the very employees the bills seek to protect. H.R. 3669, introduced by Congressmen Portman and Cardin, take account of this and are a step in the right direction.

ERIC supports legislation to help employees make their investment choices wisely. In particular, ERIC supports changes in current law to facilitate employers' efforts to make investment advice available to employees. The provisions of H.R. 3669 also address that and are a step in the right direction.

Finally, I would like to turn to ERISA section 404(c). In general terms, 404(c) allows a participant to direct the investment of the assets in his or her account. It is appropriate to require that fiduciaries of a 404(c) plan, to give employees adequate advance notice of any planned suspension of investment activity, often referred to as a blackout period. Where feasible, advance notice will give employees a chance to make appropriate changes in their investment elections before the blackout period begins. If the blackout period is so long that it does not give employees the right to make sufficiently frequent changes in investments, 404(c) will cease to apply under current law. There is no need to amend 404(c) to achieve this result.

Any blackout period legislation should take account of the practical realities that exist when such periods are necessary. For example, any legislation should require only reasonable advance notice to affected participants, not impose arbitrary and potentially impractical time limits, and not conclude that 404(c) does not apply automatically.

That completes my prepared statement. I am certainly available and pleased to answer any questions that the Committee may have, and I appreciate the opportunity to appear here today and express our views.

[The prepared statement of Mr. Macey follows:]

Statement of Scott J. Macey, Senior Vice President, AON Consulting, Somerset, New Jersey, and Member, Board of Directors, ERISA Industry Committee

Good afternoon, Mr. Chairman. I very much appreciate the opportunity to speak with you and the Subcommittee today about employer-sponsored individual account plans.

I am appearing today on behalf of The ERISA Industry Committee, commonly known as "ERIC." ERIC is a nonprofit association committed to the advancement of the employee retirement, incentive, and welfare benefit plans of America's largest employers. ERIC's members provide comprehensive retirement, incentive, and other benefits directly to some 25 million active and retired workers and their families.

I am Senior Vice President of AON Consulting. In addition, for 25 years I was a senior member of the law department at AT&T, where I was responsible for employee benefit issues affecting that company. I am also a member of the Board of Directors and a former Chairman of ERIC.

TAX TREATMENT OF STATUTORY STOCK OPTIONS

Initially, ERIC would like to strongly commend the Chairman for introducing H.R. 2695, which clarifies the tax treatment of statutory stock options by providing that neither the exercise of a statutory stock option nor the disposition of option shares is subject to income tax withholding or employment tax. ERIC strongly believes that H.R. 2695 is consistent with current law and applauds the Chairman's effort to clarify current law to facilitate the grant of stock options to employees.

Recruiting, retaining, and motivating talented employees are essential to a company's success in today's highly competitive global economy. Many employers grant stock options to employees throughout the workforce, including rank-and-file employees. These employees, and rank-and-file employees in particular, will be harmed if their statutory options are subjected to employment taxes.

Employers use stock options to recruit, retain, and motivate employees, to give employees a stake in their employer, and to align the interest of employees with the interests of the employer. H.R. 2695 will help employers and employees to achieve these important objectives, which are critical to the current economic recovery.

We are deeply appreciative of the Chairman's efforts. We will be pleased to continue to support the Chairman's efforts to secure prompt enactment of H.R. 2695. With the thought that it might be helpful to the Subcommittee, I am attaching to this statement a copy of ERIC's submission to the Internal Revenue Service on the stock option issue.

EMPLOYER-SPONSORED INDIVIDUAL ACCOUNT PLANS

Employee accounts in employer-sponsored § 401(k) and other individual account plans have been enormously successful in providing employees and their families with financial security and retirement savings. As of the end of 2000, approximately 42 million employees had accounts in § 401(k) plan accounts, representing $1.8 trillion in assets.[1] Individual account plans have enabled millions of individual employees to accumulate very substantial savings that have allowed them and their families to enjoy a comfortable retirement. It has been estimated that within the next 25 years, § 401(k) plans may be producing retirement benefits exceeding those produced by the Social Security system.[2]

At the same time, employer-sponsored retirement plans are voluntary arrangements. Employers are not required to sponsor retirement plans for their employees; they are not required to contribute to their profit sharing and stock bonus plans; and they are not required to make matching contributions to their § 401(k) plans. Total § 401(k) plan contributions are clearly higher, however, in plans where the employer matches employee contributions than in plans where there is no employer match.[3]

Plan Investments in Employer Stock

In addressing the many issues raised by the Enron matter, Congress is faced with a difficult decision regarding the treatment of individual account plan investments in employer stock. As recent events demonstrate, although employees whose retirement benefits are based on the value of employer stock have the opportunity to enjoy substantial gains and an increase in their retirement benefits if the stock price appreciates, they also are exposed to the risk that the value of the stock will fall, with a concomitant reduction in their retirement benefits.

But for every employee who suffered as a result of Enron's collapse, there are a great many more who have benefited mightily by investing in employer stock under other companies' § 401(k) plans. It has been estimated that if § 401(k) plans were not permitted to invest in employer stock, employees' investment returns under their § 401(k) plans would be substantially reduced.[4]

If Congress responds excessively to the risks associated with stock-based plans by imposing restrictions that prevent these plans from meeting employers' business needs, Congress will have addressed one risk by creating a different and more dangerous risk: that millions of employees will be unable to share in their employers' success. In addition, excessive legislative limits on investments in employer stock may cause employers to reduce their commitments to their plans, resulting in significant reductions in employees' retirement savings.

The task facing Congress is made more difficult because the issues do not relate solely to employer-sponsored retirement plans. Many of the issues relate to the accuracy, adequacy, and timeliness of the disclosures made to shareholders generally, including those who hold stock outside of an employer-sponsored plan. The way in which such disclosure issues are resolved could affect, and to some extent may obviate, Congress's decisions regarding the stock held by an employer-sponsored plan.

Employer Stock Plans

Employee stock ownership, stock bonus, and other stock-based plans are not only permitted by ERISA; they are strongly and affirmatively promoted by numerous provisions of law that have encouraged employers for nearly a century—since 1921—to maintain stock-based individual account plans for their employees.[5]

Employee benefit plans serve important business purposes in addition to providing a safety net for retirement. A key business purpose is to attract and retain talented employees. Employers compete with each other for talented employees by, among other things, designing and offering benefit plans that respond affirmatively

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[1] Sarah Holden & Jack VanDerhei, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2000," Employee Benefit Research Institute Issue Brief at 3 (Nov. 2001).

[2] James M. Poterba, Steven F. Venti, & David A. Wise, "401(k) Plans and Future Patterns of Retirement Saving," American Economic Review at 183 (May 1998).

[3] Sarah Holden & Jack VanDerhei, "Contribution Behavior of 401(k) Plan Participants," Employee Benefit Research Institute at 10 (Oct. 2001) "total contribution rates for participants in plans with employer contributions were 2.8 percentage points higher than total contribution rates for participants in plans without employer contributions" (footnotes omitted)).

[4] Statement of Jack VanDerhei at 5–6, Hearing on Retirement Security and Defined Contribution Pension Plans, Ways and Means Comm., U.S. House of Representatives (Feb. 26, 2002).

[5] *See, e.g.,* Revenue Act of 1921, § 219(f) (tax exemption); Tax Reduction Act of 1975, P.L. 94–12, § 301, Tax Reform Act of 1976, P.L. 94–455, § 803, and Revenue Act of 1978, P.L. 95–600, § 141 (tax credits) (repealed); IRC §§ 401(a) & 501(a) (tax exemption), 404(k) (dividend deduction) and 1042 (tax-deferred sales).

to current and prospective employees' wishes and needs, which often include highly-valued access to the employer's stock.

Employer stock plans give employees the opportunity to purchase employer stock economically, conveniently, and tax-efficiently. Employees highly value the opportunity to invest in employer stock, the stock they know best.

Employees have benefited enormously from participating in employer stock plans. These plans have allowed employees to benefit from substantial appreciation in the value of the companies that employ them.

Employer stock plans also serve the important purpose of aligning the interests of employees with the interests of the employer's business and encouraging employees to be attentive to the interests of the business. The following simple anecdote illustrates this point. After one company suffered losses because its delivery people regularly discarded expensive containers after they took the company's merchandise out of the containers and placed the merchandise on retailers' shelves, the company responded by printing the logo of its stock plan on the containers. The delivery people immediately got the point: they saw the connection between their returning the containers to the company for reuse and their own benefits from the company's stock plan. The company, and its employee-owners, saved millions of dollars a year as a result of this program.

ERIC Opposes Caps on Employer Stock

Congress should allow employees to make their own decisions regarding the diversification of their participant-directed accounts. Congress should not restrict an employee's right to allocate all or part of his or her participant-directed account to any investment offered by the plan, including employer stock.

The Treasury Department recently reported that placing arbitrary caps on individual § 401(k) account holdings in employer stock would have a widespread impact on plan participants, and potentially severe disruptive effects on the stock prices of major companies. The Treasury report also found that arbitrary caps fail to take into account workers' total retirement portfolios, that arbitrary caps will be very difficult to administer (requiring tens of thousands of individual computations annually or even more frequently), and that arbitrary caps would require a large number of participants to sell their current holdings of employer stock and also would discourage employers from making matching contributions.[6] Moreover, arbitrary caps would have the perverse effect of limiting employee investments in America's most successful companies as their stock prices rise.

Employees place great value on the freedom to make their own investment choices. Congress should not abridge that freedom.

Likewise Congress should not reduce the deduction to which an employer is entitled merely because its contribution is made in employer stock rather than in cash. An employer should be permitted to deduct the value of its contribution to the plan, regardless of whether the contribution is in cash or in stock.

Diversification Rights

In light of the Enron matter, it may be appropriate for Congress to amend existing law to give employees greater rights to diversify their individual account plan investments. Current law requires an employee stock ownership plan to allow a participant to diversify a portion of his or her account balance after attaining age 55 and completing 10 years of participation.[7]

On the other hand, Congress also should allow stock-based plans to achieve their objective of aligning the interests of employees with the interests of the employer's business. It is one thing for Congress to give employees the right to diversify their investments at some point. It is quite another to give them diversification rights so early that the employer's objective in having a stock-based plan is subverted.

The vast majority of major employers sponsor both defined benefit plans and individual account plans for their employees. In these circumstances, the employer's individual account plan is only one component of the employer's comprehensive retirement program; employees do not rely on the individual account plan alone for retirement security. As a result, it can be quite misleading to measure the diversification of an employee's retirement savings by looking only at his or her § 401(k) account. A substantial portion of many employees' retirement savings is attributable to their benefits in the employer's defined benefit retirement plan under which benefits are determined by the plan's formula rather than the investment performance of the plan's assets. Moreover, under most stock-based programs, it is only the employer's

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[6] Report of the Department of the Treasury on Employer Stock in 401(k) Plans (Feb. 28, 2002) (the "Treasury Report").

[7] IRC § 401(a)(28).

contributions (not the employee's payroll deduction contributions) that are subject to investment restrictions.

The challenge facing Congress is to strike the correct balance between diversification and the objectives of a stock-based plan. Although it is difficult to state with certainty just how and where to strike the balance, there are a number of possible alternatives that merit consideration. The Subcommittee might consider, for example, one or more of the following:

- Several alternative diversification schedules, any one of which a plan could adopt. Under this approach, a plan could comply by granting employees diversification rights after they meet the requirements of a schedule that is at least as favorable to employees as one of several alternative statutory schedules (based, for example, on years of plan participation, age, or both). Congress has followed this approach under ERISA for vesting and benefit accrual purposes.
- A "class year" approach under which investments attributable to contributions made for a given year would become eligible for diversification after the employee completes a specified number of years of participation after the year for which the contributions were made.
- Differentiating among types of contributions, so that employees would have earlier diversification rights with respect to some types of contributions than with respect to others. For example, distinctions might be drawn among employee contributions (including § 401(k) contributions), matching employer contributions, and nonmatching employer contributions.
- Distinguishing between types of plans (*e.g.,* between traditional § 401(k) plans and employee stock ownership plans), so that employees would have earlier diversification rights under some types of plans than under others.
- Distinguishing between situations involving employee choice and those not involving choice (*e.g.,* distinguishing between plans that offer a greater match if the employee elects to have it made in employer stock and plans that do not offer employees such a choice).

We will be pleased to work with the Subcommittee and its staff to explore the issues involving diversification rights and to develop these possibilities into specific legislation.

Transition and Effective Date Issues Should Be Addressed

The Subcommittee should carefully address the transition and effective date issues raised by the pending bills. Many stock-based plans have been around for decades. They hold substantial blocks of employer stock. If new employer stock rules go into effect immediately, without adequate transition or phase-in, there is a substantial risk that stock prices will be adversely affected and that significant losses will be imposed on the very employees the bills seek to protect.

If Congress enacts legislation that requires or encourages plans to dispose immediately of their substantial holdings of employer stock, the shares sold by the plan could easily represent multiples of the average daily trading volume for the stock, flood the market with stock, and significantly reduce the stock price. The primary victims will be the plan participants who are attempting to diversify their retirement savings.[8]

Accordingly, we urge the Subcommittee to consider providing for a deferred effective date or a phase-in period for any new diversification requirements. An appropriate deferred effective date or phase-in period will protect plan participants by permitting plans to liquidate their stock holdings in an orderly way that does not put unnecessary downward pressure on the price of employer stock. H.R. 3669, introduced by Congressmen Portman and Cardin, makes a good start at addressing these important issues.

Investment Advice

ERIC supports efforts to help employees to make their investment choices wisely. For example, ERIC supports changes in current law to facilitate employers' efforts to make investment advice available to plan participants.

For example, we support the provisions of H.R. 3669 that would permit employees to elect between receiving taxable compensation and qualified retirement planning services. ERIC will be pleased to work with the bill's sponsors to achieve enactment of this very constructive provision.

[8] The recently-issued Treasury Report supports our concern. See note 6, *supra.*

ERISA'S Fiduciary Standards

Many of those advocating amendments to ERISA's fiduciary standards proceed from the mistaken premise that stock-based plans are largely exempt from those standards. To the contrary, the fiduciaries of *all* ERISA-governed plans, *including* stock-based plans, are subject to rigorous fiduciary duties under ERISA. These standards are enforceable by plan participants and beneficiaries, by other plan fiduciaries, by the Secretary of Labor, and, in some cases, by the Internal Revenue Service.[9]

Fiduciaries are subject to a duty of loyalty under ERISA. They must act solely in the interest of plan participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable plan administration expenses.[10]

Fiduciaries are also subject to a duty of prudence that requires them to act with the care, skill, prudence, and diligence that a prudent man familiar with such matters would use in similar circumstances.[11]

In general, fiduciaries must diversify the investments of the plan to minimize the risk of large losses, unless under the circumstances it is prudent not to do so.[12]

Fiduciaries also must act in accordance with terms of the plan—but only to the extent that the terms of the plan are consistent with ERISA.[13]

While these general rules also allow stock-based plans to acquire and retain substantial holdings of employer stock, the fiduciaries of stock-based plans remain subject to the duties of loyalty and prudence.[14]

ERISA subjects fiduciaries to the duties of the trustees of an express trust—*the highest fiduciary obligations known to the law*.[15] The Supreme Court has made it clear, for example, that the duty of loyalty forbids a fiduciary from making intentional misrepresentations about the plan to employees. As the Supreme Court put it, "To participate knowingly and significantly in deceiving a plan's beneficiaries in order to save the employer money at the beneficiaries' expense is not to act 'solely in the interest of the participants and beneficiaries.'"[16]

Fiduciaries who breach their duties under ERISA are personally liable to make good any losses to the plan as a result of the breach and are personally liable to restore to the plan any gains the fiduciaries realize through the use of plan assets. They are also subject to any other equitable relief that the court deems appropriate.[17]

In addition, ERISA's prohibited transaction provisions categorically bar certain transactions between the plan and related parties and prohibit misconduct by fiduciaries, such as self-dealing, representing parties with interests contrary to those of the plan, and receiving kickbacks.[18]

The Supreme Court has recognized that ERISA permits a cause of action against not only fiduciaries, but also *nonfiduciaries* who participate in a prohibited transaction.[19]

Co-fiduciary Liability

ERISA's fiduciary duties are supplemented by rigorous co-fiduciary liability provisions, which make every fiduciary potentially liable for misconduct by every other plan fiduciary.

Under the co-fiduciary provisions, one fiduciary is liable for a breach by a second fiduciary——

- if the first fiduciary participates knowingly in, or knowingly undertakes to conceal, an act or omission of the second fiduciary, knowing that the second fiduciary is violating his fiduciary duties;
- if the first fiduciary's failure to discharge his or her own fiduciary duties enables the second fiduciary to commit a breach; or
- if the first fiduciary knows of a breach by the second fiduciary and fails to make reasonable efforts to remedy the breach.[20]

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[9] ERISA § 502; Int. Rev. Code § 4975.
[10] ERISA § 404(a)(1)(A).
[11] ERISA § 404(a)(1)(B).
[12] ERISA § 404(a)(1)(C).
[13] ERISA § 404(a)(1)(D).
[14] *See, e.g.,* ERISA §§ 404(a)(2), 407(b), 408(e); *Moench v. Robertson,* 62 F.3d 553 (3d Cir. 1995); *Kuper v. Iovenko*, 66 F.3d 1447 (6th Cir. 1995).
[15] *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982).
[16] *Varity Corp. v. Howe*, 516 U.S. 489, 506 (1996).
[17] ERISA § 409(a).
[18] ERISA §§ 406—408.
[19] *Harris Trust & Sav. Bank v. Salomon Smith Barney Inc.,* 530 U.S. 238 (2000).
[20] ERISA § 405(a).

Proposed Expansion of ERISA

The widely-reported losses suffered by participants in the plans of Enron Corporation have been attributed to the alleged misconduct of Enron officials. If the allegations are correct, the alleged misconduct goes well beyond a violation of ERISA's fiduciary standards. If the allegations of corporate misconduct are correct, they also suggest the possibility that federal securities and other laws have been violated. New fiduciary standards or new restrictions on holdings of employer stock under ERISA are not well-suited toward curbing conduct of the kind that has been alleged.

ERIC favors vigorous enforcement of the federal securities laws and ERISA to assure that employees, and investors in general, have the information they need to make informed investment decisions.

ERIC strongly opposes proposals to add new remedies to ERISA and to impose liability on persons who are not plan fiduciaries. As I have explained, ERISA already subjects fiduciaries to rigorous standards of conduct and imposes personal liability on fiduciaries who violate those standards. The Supreme Court has held that nonfiduciary parties in interest who participate in prohibited transactions also may be held liable under ERISA.[21] There is no need to go further. Expanding ERISA liability will strongly discourage employers from adopting health, retirement, and other plans for their employees. These proposals will harm employees, not help them.

ERIC also strongly opposes proposals that have been made for the joint trusteeship of individual account plans. Joint trusteeship will be divisive, disruptive, and counter-productive. It will politicize fiduciary responsibility. It will create employee relations strife. It will allow unions to speak for nonunion workers. It will require employers to spend resources on conducting elections rather than on discharging fiduciary responsibilities. It will disrupt, rather than strengthen, plan management. And because it will discourage employers from setting up plans, it will reduce retirement savings.

ERISA § 404(c) and Blackout Periods

Many individual account plans are participant-directed plans that allow each participant to allocate his or her account balance among a number of investment options made available by the plan. These are commonly referred to as "§ 404(c) plans," after the ERISA section that allows these arrangements.

Temporary suspensions in trading activity ("blackout periods") in participant-directed plans are often necessary to accommodate changes in plan administration, such as a change in the plan's record-keeper, a change in the plan's administrative system, or a merger with another plan. Blackout periods also occur for unanticipated reasons, such as a power outage, a computer failure, or other unanticipated events.

Although many participant-directed individual account plans allow participants to change the way their accounts are invested on a daily basis, plans are not required to permit daily changes in investments, and the vast majority of participants do not make daily changes. Indeed, daily investment changes are often discouraged. Frequent trading is inconsistent with the plan's role as a vehicle for long-term retirement savings.

ERISA's current fiduciary standards appropriately regulate plan administrators' decisions regarding (a) the need for a blackout period, (b) the duration of any blackout period, (c) the need for, and timing and content of, a notice to plan participants regarding the blackout period, and (d) the timing of the blackout period itself.

There is nothing in § 404(c) that requires participants to be allowed to make daily changes in their accounts. In fact, the Labor Department's regulations contemplate that quarterly changes can be sufficient in some cases. The Administration's proposal—under which *any* interruption in investment activity (no matter how brief) automatically results in the loss of § 404(c) protection—is based on the mistaken premise that any hiatus in investment activity is outside § 404(c).

Section 404(c) plans have been enormously successful in encouraging employees to save. Employees appear to be more likely to choose to save if they have some control over how their savings are invested. Employers are certainly more likely to adopt and to expand these plans if they are not liable for the investment choices made by plan participants in light of each participant's own circumstances and objectives.

We are concerned that any narrowing of § 404(c) could cause employers to respond by curtailing their plans' participant-direction features. This is likely to make these

[21] *Harris Trust & Sav. Bank, supra.*

plans less attractive to employees and to dampen their enthusiasm for retirement savings.

We believe it is appropriate to require plan fiduciaries to give participants adequate advance notice of any planned suspension of investment activity. Where it is feasible, advance notice will give participants a chance to make appropriate changes in their investment elections before the suspension period begins. And if the suspension period is so long that it does not give participants the right to make sufficiently frequent changes in their investments, § 404(c) will cease to apply under current law. There is no need to amend § 404(c) to achieve this result.

Any blackout-period legislation should meet the following requirements:

- If advance notice of a blackout period is required, it should be required to be given no more than 21 days before the beginning of the blackout period; this is the approach taken by H.R. 3669.
- Any advance notice should be required to be given only to the individuals reasonably expected to be affected by the blackout period, not to all plan participants.
- Advance notice should not be required where the blackout period is the result of an emergency or other event that is not reasonably foreseeable.
- The legislation should not impose an arbitrary limit on the duration of a blackout period; the duration of a blackout period is generally dictated by technological or systemic considerations that are beyond the employer's control.
- The legislation should recognize that many major employers maintain numerous participant-directed plans; a blackout period affecting one plan (covering perhaps a tiny percentage of the employer's workforce) should not affect the rights of officers and other employees who do not participate in that plan.
- The legislation should modify the generally applicable rules to take into account the circumstances in which a blackout period is necessitated by a business acquisition or disposition; any notice or other requirements imposed on blackout periods should be flexible enough to accommodate the exigencies of these situations.
- The legislation should not adopt a per se rule under which a plan automatically falls outside of § 404(c) during a blackout period. A brief blackout period does not necessarily cause a participant to lose control over the investments in his or her account—particularly where the participant received adequate advance notice of the blackout period and had a chance to make appropriate changes in his or her investment portfolio before the blackout period began.

The issues under consideration are difficult. They should not be resolved without careful fact-finding and analysis. Hasty adoption of well-intentioned but ill-considered legislation risks harming the very employees the legislation is designed to protect: the employees who participate in voluntary employer-sponsored plans. We urge the Committee to study the facts and the issues in depth before making recommendations.

For our part, we intend to continue to study the issues and develop additional recommendations which we will communicate to you promptly.

We very much appreciate the opportunity to submit this statement. We look forward to working constructively with the Subcommittee and its staff on these challenging and important issues.

That completes my prepared statement. I will be pleased to answer any questions the Chairman or any members of the Subcommittee might have. Thank you for your attention.

Chairman HOUGHTON. Thanks very much. Mr. Little?

STATEMENT OF GENE E. LITTLE, SENIOR VICE PRESIDENT, FINANCE AND TREASURER, TIMKEN COMPANY, CANTON, OHIO, ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. LITTLE. Chairman Houghton, Members of the Subcommittee, thank you for the opportunity to appear before you today to present the views of the Timken Company and the National Association of Manufacturers. I am Gene Little, Senior Vice President of Finance.

Timken Company, headquartered in Canton, Ohio, is the largest producer of tapered roller bearings and seamless mechanical alloy tubing. Founded in 1899, the company had $2.4 billion in sales last year. We have 18,700 associates working at 50 plants and more than 100 sales, design, and distribution centers, 24 countries on 6 continents. The company has been listed on the New York Stock Exchange for 80 years.

Defined contribution plans like 401(k) plans are a foundation of our private retirement system. Currently, 401(k) plans cover more than 42 million American workers at thousands of companies, many of them small- to mid-size companies, and they hold $2 trillion in assets, which is about 15 percent of the value of the New York Stock Exchange.

The National Association of Manufacturers' 14,000 Member companies are extremely concerned that hasty legislative action in response to the collapse of Enron will have a negative impact on our voluntary retirement system, widespread stock ownership among employees, and the 401(k) assets and retirement security of millions of employees. It is imperative that Congress and the administration fully investigate the facts surrounding the Enron case before making any changes to current retirement policy or regulation.

Diversification proposals that mandate shifts out of company stock, including caps and limits on holding periods, can harm the ability of employees to save for their retirement. Existing laws already require a strict level of fiduciary behavior for pension plan sponsors and provide stringent sanctions for any violations. Increasing employer liability will reverse recent efforts to expand pension benefits for American workers.

401(k) retirement plans at Timken cover 11,600 associates. They contribute an average of 7 percent of their pay and the company contributes an additional 4.4 percent in company stock. These plans have existed for about 20 years and contain $546 million in assets. More than $100 million, or about 20 percent of those assets, are shares of company stock contributed by the company.

In addition, associates direct a portion of their own contributions into stock. Last year, company stock provided a better return than the other eight investment alternatives.

In the aggregate, company associates own about 21 percent of the outstanding shares of the Timken Company through its 401(k) plans. 401(k) plans have made investors out of millions of workers. Their asset investments are visible, able to be managed, and portable. Legislating investment alternatives begins to erode individuals' rights.

Company stock and 401(k) plans has been a powerful contributing factor to the economic out-performance enjoyed by the U.S. economy relative to other industrialized nations over the past decade. It brings about alignment within the company among its associates. It makes associates owners, a tremendous catalyst for productivity. And company stock as a benefit is, as you know, an important enabler for startup companies.

Changes to expand the flexibility regarding the holding of company shares are necessary and advancing rapidly. Legislating arbitrary divestitures or shareholding limitations for company stock could have a dramatic negative consequence for both companies

and individuals. Telling an employee to sell or not invest in his company stock because another company like Enron behaved irrationally can be likened to forcing an American to not buy or sell U.S. bonds because a government department operated dysfunctionally.

As a global company but with a majority of its business in the United States, Timken observes what a significant element retirement security plans are and how the United States is different than Europe, Asia, and less-developed nations whose workers mostly do not have private pension plans. Hastily considered pension legislation could have two undesirable consequences. One, private companies could reduce or eliminate pension benefits, which would shift more of the burden to government. Second, jobs could be transferred to other countries. Post-employment benefits are a big element in determining manufacturing capacity locations.

Defined benefit plans constitute the other important leg of our country's private retirement system. Timken has U.S. defined pension plans covering 24,000 associates. The value of the assets in those plans is $1.3 billion, larger than the book or market value of the company's equity.

Last year, we had a pension plan expense of $60 million and contributed a greater amount into our pension plan. There has been an artificial burden placed on companies' funding of these plans as a consequence of the government's October announcement to stop issuing 30-year Treasury bonds. The resulting drop in yields on those bonds incorrectly and artificially inflates cash contributions required to meet pension obligations.

We also are grateful to Representative Rob Portman for working on legislation, along with Representatives Johnson and Pomeroy, to address this irregularity. Without an equitable method of calculating contributions, more countries will move away from providing defined benefit plans and many, many companies will be faced with massive cash outlays that can prolong or prevent recovery from the deep manufacturing recession for a good period of time.

Thank you for inviting me here today, and I look forward to discussing any issues you would ask of me.

[The prepared statement of Mr. Little follows:]

Statement of Gene E. Little, Senior Vice President, Finance and Treasurer, Timken Company, Canton, Ohio, on behalf of the National Association of Manufacturers

Chairman Houghton and members of the subcommittee, thank you for the opportunity to appear before you today to present the views of The Timken Company and the National Association of Manufacturers on Retirement Security. I am Gene Little, Senior Vice President—Finance and Treasurer of The Timken Company.

The NAM—18 million people who make things in America—is the nation's largest industrial trade association. The NAM represents 14,000 member companies (including 10,000 small and mid-sized companies) and 350 member associations serving manufacturers and employees in every industrial sector and all 50 states. Headquartered in Washington, D.C., the NAM has 10 additional offices across the country.

The Timken Company, headquartered in Canton, Ohio, is the world's largest producer of tapered roller bearings and seamless mechanical alloy steel tubing. Founded in 1899, the company had $2.4 billion in sales in 2001. The Timken Company has 18,700 associates working at 50 plants and more than 100 sales, design and distribution centers located in 24 countries on six continents. The company has been listed on the New York Stock Exchange (NYSE) for 80 years.

Defined contributions plans, like 401(k) plans, are a foundation of our private retirement system. Currently, 401(k) plans cover more than 42 million American workers at thousands of companies—many of them mid to small size—and hold $2 trillion in assets, almost 15% of the value of the NYSE.

On behalf of the National Association of Manufacturers and its 14,000 member companies, we are extremely concerned that hasty legislative action in response to the collapse of Enron will have a negative impact on our voluntary retirement system, widespread stock ownership among employees and the 401(k) assets and retirement security of millions of employees. It is imperative that Congress and the Administration fully investigate the facts surrounding the Enron case before making any changes to current retirement policy or regulation.

Diversification proposals to mandate shifts out of company stock, including caps and limits on holding periods, will harm, not enhance, the ability of employees to save for their retirement.

Existing laws already require a strict level of fiduciary behavior for pension plan sponsors and provide stringent sanctions for any violations. Increasing employer liability will reverse recent efforts to expand pension benefits for American workers.

With regard to lockout periods, please note that these transaction suspension periods are not uncommon, but they are for only a very short time. Transactions are barred during this period so that a new record keeper can verify account accuracy and reconcile records. Lockouts often result in new plan features or investment options for employees. Restrictions on these periods could interfere with the normal process of improving 401(k) plans.

There are seven 401(k) U.S. retirement plans at The Timken Company covering 11,600 associates. Associates contribute an average of 7% of their pay and the company contributes roughly an additional 4.4% in Company stock.

These plans have existed for about 20 years and contain $546 million in assets. More than $100 million or about 20% of those assets represent shares of company stock contributed to the associates' accounts by the company. In addition, associates have elected to direct a portion of their own contributions into company stock. (Last year company stock provided a better return than the other eight investment alternatives.) In the aggregate, through our 401(k) plans, company associates own about 21% of the outstanding shares of The Timken Company.

401(k) plans have made investors of millions of workers. Their asset investments are visible, able to be managed and portable. Legislating investment alternatives begins to erode individuals' rights.

Company stock in 401(k) plans has been a powerful contributing factor to the economic outperformance enjoyed by the U.S. economy relative to other industrialized nations over the past decade or so. Company stock ownership has several other benefits:

- it brings about alignment within a company among its associates;
- making associates owners is a tremendously powerful catalyst for productivity;
- company stock as a benefit is, as you all know, an important enabler for start-up companies.

Changes to expand the flexibility regarding the holding of company shares are necessary and advancing rapidly. Legislating arbitrary divestitures or shareholding limitations for company stock could have dramatic negative consequences for both companies and individuals alike.

Telling an employee to sell or not invest in his company's stock because another company like Enron behaved irrationally can be likened to forcing an American to not buy or sell U.S. bonds because one government entity behaved dysfunctionally.

As a global company, but with a majority of its business in the U.S., Timken is in a good position to observe what a significant element retirement security plans are and how the U.S. is different than Europe, Asia and less developed nations whose workers for the most part do not have private pension plans.

Hastily considered pension legislation could have two undesirable consequences:

- private companies could reduce or eliminate pension benefits which would shift more of the burden to government over time; and
- jobs could be transferred to other countries—post employment benefits are a very big element in determining where we locate manufacturing capacity.

Defined benefit plans constitute the other important leg of our country's private retirement benefit system. Timken has four U.S. defined benefit pension plans covering 24,000 active, deferred vested, and retired associates. The value of the assets is $1.3 billion, which is larger than the book or market value of the company's equity.

Last year, we had a pension expense of $60 million and contributed a greater amount into our pension plan. There has been an artificial burden placed on companies' funding of these plans as a consequence of the government's October 31, 2001, announcement to stop issuing 30 year treasury bonds. The resulting drop in yield on these bonds incorrectly and artificially inflates the cash contributions required to meet pension obligations.

We are grateful to Representative Rob Portman for working on legislation which addresses this irregularity. Without an equitable method of calculating contributions, more companies will move away from providing defined benefit pension plans, and many, many companies will be faced with massive cash outlays that can prolong or prevent recovery from the deep manufacturing recession for a number of years.

Thank you for inviting me here today to discuss these important issues.

Chairman HOUGHTON. Thank you, Mr. Little. Mr. Hoffman?

STATEMENT OF CRAIG HOFFMAN, VICE PRESIDENT AND GENERAL COUNSEL, SUNGUARD/CORBEL, JACKSONVILLE, FLORIDA, AND PRESIDENT, AMERICAN SOCIETY OF PENSION ACTUARIES, ARLINGTON, VIRGINIA

Mr. HOFFMAN. Thank you, Mr. Chairman and Members of the Subcommittee. My name is Craig Hoffman. I am Vice President and General Counsel of SunGard Corbel. SunGard Corbel is the nation's largest supplier of PC-based software and technical support to retirement plan administrators.

I am here today to present the views of the American Society of Pension Actuaries (ASPA), for whom I currently serve as President. The ASPA is a national organization of over 5,000 retirement plan professionals who provide consulting and administrative services for retirement plans covering millions of American workers. The vast majority of these plans are maintained by small businesses.

The ASPA applauds this Subcommittee's leadership in exploring how our pension laws may need to be strengthened. However, it is important that any legislative response to the ENRON tragedy be carefully measured. I would like to summarize ASPA's views on several issues.

First, as Congress debates possible new pension laws, it is important to cautiously consider any new burdens that may be imposed on small businesses.

Plan sponsors must be able to change service providers to improve plan administration without being subject to undue restrictions or liability.

Thirdly, the ability to diversify participant-directed investments should be enhanced.

And finally, further steps should be taken to improve the retirement security of American workers.

The ASPA commends Congressmen Portman and Cardin for their legislation, the Employee Retirement Savings Bill of Rights. The legislation would improve the rights of plan participants to diversify their retirement savings, require employers to provide employees educational information on the importance of diversification, and require 21 days' notice to employees in advance of so-called lockdowns or blackouts. These common sense provisions will help American workers achieve retirement security without discouraging retirement plan coverage. In particular, by providing an

exception for closely held stock, the bill effectively addresses the special concerns faced by small businesses.

However, as the Subcommittee further evaluates this and other legislation, ASPA believes you should consider the following. Stand-alone employee stock ownership plans (ESOPs) funded entirely with employer non-elective contributions, no employee or matching contributions, should be treated differently. ESOPs are an important way to enable American workers to obtain a stake in their company.

Second, it should be clear that any new notice or statement requirements could be provided by electronic means. This will significantly reduce the cost of administering a plan, a particular concern of small business.

Delayed effective dates are needed to give plan sponsors and plan administrators the time necessary to change systems to effectively implement any new legal requirement. For example, the new notices required by the bill would be effective 60 days after regulations are issued. It is virtually impossible for plan sponsors, particularly small businesses, to practically comply with that kind of timeframe.

Proposals have been made to place time limits on blackouts. In the experience of ASPA Members, blackout periods are necessary to change service providers, which is often done for the purpose of improving investment options or other plan features offered to participants. The ASPA believes that advance notice of blackouts should be required but opposes any predetermined restrictions on the length of lockdowns.

The ASPA does agree, as suggested by the administration, that employers should bear the fiduciary responsibility of monitoring plan investments during a blackout. However, those employers, particularly small businesses, need clear regulatory guidance on how to comply with this responsibility during a blackout period.

Another issue raised by the Enron situation is the investment of plan assets in employer stock. The ASPA believes that employees should generally be provided with choice as to investing in employer stock. However, it is important that any diversification requirements take into consideration the special concerns of small businesses whose stock is not publicly traded. To further promote diversification, ASPA supports the administration proposal to require quarterly statements.

However, it is critical that this requirement be limited to only plans that permit participants to direct investments. Otherwise, it could be extremely burdensome for small businesses to comply. For example, it would be very expensive for small businesses to have to quarterly value closely held stock.

Finally, if Congress wants to provide greater retirement security for American workers, it is time to revitalize defined benefit plans and make them attractive to both employers and employees. The ASPA is working on a proposal that combines the best features of 401(k) plans, namely participant choice, with the best features of defined benefit plans, namely a guaranteed benefit. It is called a DBK, and we would be happy to discuss it more with you.

Thank you again, Mr. Chairman and Members of the Subcommittee. I, too, would be happy to answer any questions you might have.

[The prepared statement of Mr. Hoffman follows:]

Statement of Craig Hoffman, Vice President and General Counsel, SunGard/Corbel, Jacksonville, Florida, and President, American Society of Pension Actuaries, Arlington, Virginia

Introduction

Thank you, Mr. Chairman and members of the subcommittee. My name is Craig Hoffman. I am Vice President and General Counsel of SunGard Corbel, a division of SunGard, headquartered in Jacksonville, Florida. SunGard Corbel is the nation's largest supplier of pc-based software and technical support to retirement plan administrators and other professionals who work with retirement plans.

I am here today to present the views of ASPA, for whom I currently serve as President. ASPA is a national organization of over 5,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. The vast majority of these plans are maintained by small businesses. ASPA members are retirement plan professionals of all types, including consultants, administrators, actuaries, and attorneys. ASPA's membership is diverse, but united by a common dedication to the private pension system.

ASPA shares the concerns of this subcommittee, of the Congress, and of America about the tragic consequences arising from the bankruptcy of Enron Corporation We applaud this committee's leadership in exploring whether, and where, our nation's pension laws may need strengthening. We also commend the subcommittee for its stated commitment to maintaining the framework of laws upon which is built a strong, employer-based system of providing retirement income benefits to our nation's workers.

However, it is critically important that any legislative response to the Enron tragedy be carefully measured. We certainly do not want to impose rules that will result in reduced retirement plan coverage. In particular, we need to carefully consider any new burdens that may be imposed on small businesses that are already struggling to provide retirement benefits to their employees. Given the experience of ASPA's membership with small business retirement plans, my remarks will highlight these potential small business concerns.

ASPA Generally Supports H.R. 3669

ASPA commends this committee's Representatives Rob Portman (R–OH) and Ben Cardin (D–MD) for their legislation, the Employee Retirement Savings Bill of Rights (H.R. 3669), which would:

- Prohibit companies from forcing employees to invest any of their own retirement savings (401(k) money) in the stock of the employer.
- Allow employees, after three years of service, to reinvest their employer's matching contributions made in publicly-traded company stock into other investment options provided under the plan.
- Allow employees, after five years of service, to have the right to diversify out of 100% of the non-elective contributions that had been made in publicly-traded company stock.
- Require 21 days notice to employees in advance of any significant period during which employees will be unable to change investment options in their company's retirement plan.
- Require companies to provide employees with an explanation of generally-accepted investment principles, such as diversification, when workers enroll in a retirement plan and annually thereafter.
- Provide a new tax incentive to help employees pay for the cost of retirement planning services.

These common sense provisions will help our nation's workers achieve the retirement security that is the goal of our nation's pension laws, without discouraging meaningful retirement plan coverage. In particular, by providing an exception for closely-held stock, the bill effectively addresses the unique challenges and special concerns faced by small businesses trying to offer a retirement plan for their employees. However, as the committee further evaluates this legislation ASPA believes that the subcommittee should consider the following:

- As with the Administration's proposal, stand-alone ESOPs, funded entirely with employer nonelective contributions—not employee or matching contributions—should be excluded from any possible changes to our nation's pension laws. ESOPs are an important way to enable American workers to obtain a stake in their company.
- It should be made clear that any new notice or statement requirements could be provided by electronic means. This will significantly reduce the costs of administrating a plan, a particular concern of small businesses.
- Delayed effective dates are needed to give plan sponsors and plan administrators the time necessary to change systems to effectively implement any new legal requirements. For example, the new notices required by the bill would be effective 60 days after regulations implementing the provision are issued. It is virtually impossible for plan sponsors, particularly small businesses, to practically comply with that limited of time frame.

Lockdowns Periods Are Necessary for Plan Administration

One issue being debated in the wake of Enron is whether the law should be amended to restrict so-called "lockdowns" of defined contribution plans. A lockdown, also called a "blackout" or "transaction suspension period," is a time during which plan participants may not direct certain transactions in their retirement plan accounts, such as transfers among investment options and participant loans, or receive final distributions.

Typically a lockdown is needed when an employer changes its pension plan service provider. It is analogous to changing ordinary checking accounts. Time is required for outstanding checks to clear, and for the new account to be set up. Similarly, accurate records cannot be compiled, transmitted, and set up by the new pension plan service provider if investment changes, loan activity and/or withdrawals are ongoing during the transfer. During such a lockdown period, participant records and plan assets must be reconciled before they are turned over to the new service provider, which must then set up the recordkeeping information for the plan on its own system. If participant records are in good order, the lockdown can often be less than a week. However, it may take much longer, particularly for small business retirement plans where records may be more difficult to gather.

ASPA recently surveyed retirement plan administrators on their experiences with lockdowns. More than 250 firms responsible for administrating over 85,000 retirement plans that permit participants to direct the investment of their retirement accounts responded to the survey. On average, lockdowns for the plans surveyed lasted between three to four weeks. However, the survey indicated that lockdowns could last two months or even longer when records are difficult to gather. Finally, the survey showed that lockdowns are relatively infrequent and usually happen for a plan only once every three to four years.

Many times a lockdown is part of a process whereby a plan sponsor changes plan service providers in order to improve the investment alternatives or other plan features offered to plan participants. However, in response to the Enron bankruptcy, proposals have been made to limit the length of lockdowns or prohibit them altogether. ASPA believes these proposals are misplaced and would actually hurt plan participants. Restrictions on lockdowns would be particularly inappropriate when a plan contains no employer stock, since there would be no opportunity for the type of manipulation that is alleged to have occurred in the Enron plan. ASPA, however, does believe that the law should be amended to require adequate notice and full disclosure to plan participants of impending lockdowns so that participants have the opportunity to make appropriate changes to their accounts in advance of a lockdown.

ASPA also agrees, as has been suggested by the Administration, that ERISA should be clarified to provide that employers have a fiduciary responsibility to monitor plan investments during a lockdown when participants are not permitted to change investment options. However, it is important to emphasize that such a proposal should not impose absolute liability for investment losses during a lockdown, such as investment losses due to typical market performance. Only when there is a fiduciary breach, should the employer be held liable. Further, it is critical that employers, particularly small businesses, be given clear guidance by the Administration on how to satisfy their fiduciary responsibilities during a lockdown. As noted earlier, lockdowns are often instituted when an employer is improving plan services for employees. Right now, because of the public controversy surrounding Enron, employers are reluctant to improve plan services for employees for fear of potential liability if they impose a lockdown. In order to give confidence to employers that they are complying with the law, regulatory guidance, including safe harbors, needs to be provided on what to do during a lockdown.

Diversification of Plan Investments

Legislative proposals have been introduced that would limit the percentage of plan assets that may be held in employer stock. Other proposals would require that plan participants be able to diversify their plan accounts out of employer stock after varying time periods. ASPA does believe it is appropriate to reexamine the rules regarding the ability of participants to diversify the investments in their individual accounts. However, ASPA is concerned about proposals to place artificial hard caps on the ability of individual participants to choose to invest in employer stock because such caps do not take into account the individual financial circumstances of each participant. For example, if an employee is covered by both a defined benefit plan and a defined contribution plan, investing a higher percentage of defined contribution assets into employer stock may be an entirely prudent investment decision due to the existence of the valuable and guaranteed defined benefit plan.

ASPA believes that plan participants should be able to exercise free choice as to investing their plan accounts in employer stock. Participants should be able to diversify their plan investments after a reasonable time, the length of which will vary depending upon the type of plan. However, it is important that any diversification requirements take into consideration the special concerns of small businesses. Small business stock is not publicly traded, and, consequently, it requires significant expense to value such stock. Generally, ERISA requires small business stock to be valued once a year. Any proposals that would require more frequent valuations would be an undue burden on small businesses.

To further promote diversification, ASPA supports the Administration's proposal to require quarterly statements. However, it is critical that this requirement be limited to only those plans that permit participants to direct investments. Otherwise, it could be extremely burdensome for small businesses to comply. For example, it would be very expensive for small businesses to have to quarterly value closely-held stock contained in an ESOP where participants do not have the right to direct investments.

Strengthening the Private Pension System

The current plight of the Enron 401(k) plan participants highlights the need to expand and reform the private pension system. This need is especially acute with respect to encouraging plan sponsors to adopt and provide defined benefit pension plans. Unlike 401(k) and other defined contribution plans, defined benefit plans provide a guaranteed retirement benefit for employees. Further, and very importantly, the employer, and not the employee, bears the risk of investing the assets of a defined benefit plan. In addition, the Pension Benefit Guaranty Corporation insures the payment of a minimum level of retirement benefits under a defined benefit plan. However, since the passage of ERISA, restrictive and complex laws have been enacted and complicated regulations issued which have seriously impeded the ability of large and small businesses alike to maintain defined benefit pension plans for their employees.

If Congress wants to provide greater retirement security for American workers, then it must do more than revise the fiduciary responsibility rules of ERISA. It is time to revitalize defined benefit plans and to once again make them attractive to both employers and employees. ASPA is developing a proposal that combines the best features of 401(k) plans—participant choice—with the best features of defined benefit plans—a guaranteed benefit. We call it the DB–K and we would happy to discuss it more with you.

Thank you, Mr. Chairman and members of the subcommittee, for this opportunity to make our views known. I would be pleased to answer any questions you may have.

Chairman HOUGHTON. Thank you very much. I would like to ask Mr. Coyne if he would care to inquire.

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

Mr. Klein, in pointing to the success of our defined contribution plan system, you testified that 56 million workers have accumulated more than $2.5 trillion in retirement savings and many have built a substantial ownership stake in the company that they work for. The question is, is that accumulation synonymous with retirement security?

Mr. KLEIN. I think it is a good question. It certainly is an important component of it. It is hard, if you are thinking of a defined contribution plan, not a defined benefit plan, then it is in great part tied to the ability to accumulate those assets to help secure your retirement. But there, of course, are many other reasons where there are these kinds of plans. That $56 million figure that I gave you, the $2.5 trillion figure relates to 401(k) plans, profit sharing plans, as well as employee stock ownership plans.

Mr. COYNE. So it is a component of the overall system, is that it?

Mr. KLEIN. That is right.

Mr. COYNE. Mr. Charles Presswood is an Enron employee who retired after 33 years as a welder and a machine operator, and during this time, Mr. Presswood watched his retirement nest egg grow to $1.2 million. As Enron collapsed, Mr. Presswood watched his retirement disappear, and in the end, his retirement was worth $6,000.

In our current DC, defined contribution plan system, where the focus is on asset accumulation, Mr. Presswood did not do very well accumulating retirement assets. He did do very well. However, today, he has no retirement as a result of the collapse. Is this an acceptable model upon which to build the retirement system? You have testified that it is a component of an overall system.

Mr. KLEIN. Sure. Absolutely. And as I say, it is a component. For example, in Enron, as in the case of almost all companies where company stock is one of the investments or is a component of the 401(k) plan, those are organizations that also sponsor traditional defined benefit pension plans. Enron was an example of that, as well. Nonetheless, three-quarters of the American population, as I testified, does not really have a traditional defined benefit pension plan.

I also think that this is where, as I said at the outset, your job is so difficult, quite frankly, because that is a travesty when we see those amounts decline. But for every anecdote relative to an Enron, there could be 100 anecdotes of companies where their 401(k) plan has done very well, where the participants in those (k) plans have done very well by being invested in company stock or something else. So this is the problem about legislating based upon specifics.

I think the issue and what can be useful in terms of being illustrative is the importance of making people realize the dangers of putting all their eggs in one basket and being able to facilitate people getting the information that they need. That is why the proposals that would require more frequent communication to employees about the importance of diversification are very positive proposals and that is why the various legislation, including the one put forward by Mr. Portman and Mr. Cardin to help people pay for investment advice on a tax-favored basis is a positive step and that is why the legislation that the House passed last November to help facilitate people getting investment advice is so crucial.

Mr. COYNE. In addition to the worker education and the investment advice, what recommendations would you provide to protect against the lack of retirement security in the DC plan system? I mean, you have made two recommendations. Are there more?

Mr. KLEIN. Well, I think that the advanced notice when there is a blackout period, that certainly would be helpful, and I think that just building upon the kinds of legislation that passed last year that helped both defined contribution plans as well as defined benefit plans prosper. It is the type of thing that is going to lead to more retirement security for more Americans.

Mr. COYNE. Mr. Hoffman, in your testimony, you state that the stand-alone ESOPs funded entirely with employer non-elective contributions, not employee or matching contributions, should be excluded from any possible changes to our Nation's pension laws. ESOPs are a very important way to enable American workers to obtain a stake in their company. Should this standard apply where the ESOP is the sole or primary source of retirement savings for participating employees?

Mr. HOFFMAN. Certainly, ESOPs have been an important part of retirement plans for many years, going back to the early twenties, and certainly Senator Long in his many years of support for ESOPs has shown in Congress a great degree of recognition that the goal of ESOPs, to give employee workers a stake in the company's profitability and potential success, has been validated over the years in the many success stories that have occurred with respect to employee stock ownership plans. I think United Airlines is one of many, and I know this is on the panels coming beyond us, there are some folks who have had more successful opportunities in being a participant in ESOPs.

So I think one must recognize that there are social objectives that are satisfied through having employee ownership above and beyond merely retirement, and so I think the traditional purpose of a retirement plan certainly is met through an ESOP, but it goes beyond that. So I believe that the special treatment of ESOPs is appropriate for the opportunity for employees to share in that enterprise and make it more efficient and I think studies—again, I am not a management consultant, but studies have shown employees who have a stake in their company's success via stock ownership, those companies are more successful in the long run, notwithstanding the occasional Enron type of situation.

Mr. COYNE. Thank you. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thanks. Mr. Portman?

Mr. PORTMAN. Thank you, Mr. Chairman. Thank you for having this hearing.

The tragedy of Enron has led to a lot more focus on pensions and I think that may be a good thing because it is truly a success story over the last 23 years. This Congress through legislation has expanded people's ability to save, and that has been brought up this morning. We now have 42 million people, for instance, with almost $2 trillion in assets in 401(k)s, many of whom had nothing before that vehicle was available. The point has also been made this morning that a lot of people have both defined benefit and defined contribution plans, and in the larger companies, particularly those that offer employer stock as a match, it is more likely than not that there will be both a defined benefit plan backing up someone's retirement security, which is a guarantee, as well as a defined contribution plan which would have employer stock as a match or as a non-elective contribution.

I think it is good we are talking about this and I think it is good that the American people are more focused on the importance of saving for their retirement and that Congress take a more careful look at this. In the last 4 or 5 years, we have put together, working with a lot of Members of this Committee, including Mr. Houghton and Mr. Coyne, Mr. Pomeroy, Mr. Johnson, who is also Chair of the Subcommittee in the Education and Work force Committee on this, Ms. Dunn, Mr. Foley, and Mrs. Thurman, some great legislation. But, frankly, it did not always get the notice it is getting now. The legislation is focused on expanding the use of all these retirement vehicles so people can save more for their retirement and also letting people have more choice, including changing the vesting period last year as we went from 5 years to 3 years and doing some of the various things that we are now talking about accelerating in response to what Enron has brought to light.

I really appreciate all the information we have gotten here this morning, Mr. Chairman, from people who are in the trenches. All of you are either involved with plans on a day-to-day basis, or in the case of Mr. Klein, you are representing companies that are involved with plans, so we appreciate it.

I have a couple of quick questions, if I might. First would be with regard to the holding period. You said, Mr. Klein, that if there was not some kind of a holding period, in other words, where companies when they provided stock as a match were not permitted to tell the employee, you need to hold that stock for a certain period of time that companies would look to other vehicles where they could require a hold of stock over a period of time. Are you referring to a non-qualified plan?

Mr. KLEIN. Yes, it might be like a stock option program, for example.

Mr. PORTMAN. So your fear is that companies would get out of the business of providing through a qualified plan, like a 401(k) or 457 or 403(b) and do something that is not subject to the same regulations and rules that a qualified plan is subject to such as a stock option plan or some other vehicle?

Mr. KLEIN. I think that employer reactions will be completely across the board. Some employers will live with the new rule. Other employers will reduce their level of contributions. Other employers will no longer make matching contributions. After all, this is employer money. It is a strictly voluntary decision on the part of the employer. We are not talking about the employee's own contribution, we are talking about the employer's contributions.

And, ironically, some employers will decide to divert some of those resources into other kinds of plans, which are also very good plans with very reasonable and positive value and rationale, like a stock option plan, where nobody questions that there should be a holding period and that it meets the objective of that plan to do so.

Mr. PORTMAN. But those plans do not back up somebody's retirement and they do not have all the protections that we have in qualified plans.

Mr. KLEIN. That would be the irony here, that it would be decreasing people's retirement security.

Mr. PORTMAN. Let me ask all the panelists a follow-up question. Mr. Pomeroy and I, as well as Mr. Johnson and others, have legislation which does limit what someone in an employer position can do with regard to a holding period. Right now, if you are in an ESOP, you can hold somebody to 55 plus 10 years of participation. With the 401(k), there are no limits as to what you can hold someone to. We instead say, no, you ought to only be able to hold an employee to a certain period of time. Our theory is that choice is a good thing. Some holding period is appropriate to get that buy-in that many of you talked about, but that it ought to be limited.

Do you think we go too far by saying you can only hold someone for 3 years for a matching contribution or 5 years for a non-elective contribution? Does that create a problem for you? Have we gone too far in this legislation?

Mr. MACEY. I guess in trying to answer that question, I do not know that you have gone too far, but there is a delicate balance here between the employer's interest and the employee's interest, and the employee's interest is obviously to build retirement security and the employer wants to attract and retain the right type of employees and align the interests of the employees with the interests of the employer and the other shareholders so that everybody is working ultimately toward a common goal.

Somewhere along the line, perhaps we do need additional rules regarding mandatory diversification. I am not sure that 3 or 5 years, though, is the right point. Somebody who comes into employment at age 20 and puts in 3 years is really not in the same position as somebody who comes into employment at age 50 and has 3 or 5 years.

Mr. PORTMAN. And in your testimony, Mr. Macey, on page seven, you list some various diversification requirements that ought to go for different kinds of situations—someone's age, the kind of asset it is, the kind of plan it is, and so on.

I know my time is up. I need to relinquish this. But I think one of the concerns that I would have with some of these proposals is just complexity, just plain complexity, and we are trying to simplify the rules as much as you can, as you know. We tried that last year with that legislation. We made some progress.

But I would ask that you take a look at this also in terms of making sure we are not adding enormous costs or burdens to the system by having different rules for different situations. But I do agree with you that a 20-year-old has an entirely different need to look at diversification, look at holding periods, and so on, and different investment strategies, in fact, than someone who is coming in the work force later.

One final thing, Mr. Chairman, and I appreciate your indulgence, but this 30-year Treasury issue is something we are looking at, not necessarily as a permanent fix but a temporary fix by giving more flexibility, hopefully going from 105 percent to 120 percent in this legislation, and we want to work with you on that. I know Mr. Pomeroy, Mr. Johnson, and others, Mr. Houghton, are very interested in that, but this is something I feel very strongly about and we appreciate your mentioning that today.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Would you like to answer that, Mr. Macey? Would you like to have any comments on Mr. Portman's statement?

Mr. MACEY. On the question about the diversification?

Chairman HOUGHTON. Yes.

Mr. MACEY. Yes. I appreciate your comments about not adding complexity. However, if you have one rule that attempts to fit everyone, actually, that may add more factual complexity because different plans are designed differently. There are different amounts of company stock in different plans. The plans have existed for different periods of time. There may be other plans that supplement or that this is a supplement to for developing retirement security. Some plans I am aware of provide a greater company contribution if the employee elects on their own to invest in employer shares.

So I think your comment is well taken, and I agree with it. We should not be adding rules that add complexity because that is part of the whole problem with the defined benefit system. But if we are going to add some rules, if those rules were flexible enough so maybe an employer had different choices among which to amend their plan and amend their diversification rules.

Mr. KLEIN. One additional point that I think would not add any complexity whatsoever but would meet the objective would be whatever you all decide would be appropriate with respect to a timeframe, and by the way, I commend you and Congressman Cardin for having introduced legislation that says on a going forward basis there would at least be some transition rules here, and that is some percentage of employer stock should be allowed to be—the employer should be permitted to allow the individual to hold some portion for whatever period they choose. It should not be 100 percent of it.

Chairman HOUGHTON. Thanks very much.

Mr. Pomeroy.

Mr. POMEROY. Thank you, Mr. Chairman. I want to begin by thanking you for holding this hearing. It is a very important discussion, and while similar discussions are taking place in many jurisdictions all across the Hill, this particular Subcommittee has some folks on it that have worked on it a good long while and very substantively. I commend in particular my colleagues, Rob Portman and Sam Johnson, for their work in this area.

The whole question of employee stock options and their treatment on the balance sheet is an interesting one for me. I want to encourage retirement savings. I like the employer match, which I believe is the single most effective incentive out there in terms of increasing what one is doing by way of saving for retirement. On the other hand, post-Enron, we are all in a snit about integrity of balance sheets and making certain that all of the liabilities are captured in the financials.

Should we take a look, stepping back from the things that you have been talking about specifically, should we take a look at whether or not it continues to be appropriate to allow stock options to be put in as a match but not really reflected as an existing liability of the corporation? Is there an accounting conundrum there at all? Mr. Little, do you see what I am talking about?

Mr. LITTLE. Yes. Your question, I think, deals with how to account for stock options.

Mr. POMEROY. Correct.

Mr. LITTLE. That is a difficult one in that stock options can have a cost to the company, but really more to the shareholders and it is a dilution. There is currently a requirement that does not require the amount of that dilution to be calculated and disclosed. So the dilutive effects are disclosed of stock options, but——

Mr. POMEROY. How are they disclosed, in a footnote or——

Mr. LITTLE. Earnings per share, a different earnings per share with and without dilution. So there is that shareholder impact.

The difficulty with trying to say they have a value, therefore, there should be an expense, there is not necessarily a cash cost to the company associated with that option, so you find yourself booking an entry that is dealing with what may never be a cash expense to the company and that is where it may not be appropriate.

Mr. POMEROY. And we want to be loathe to disincent employer match contributions, provided that we do not foul up the integrity of their balance sheets accordingly. So it is an interesting thing, I think, we have to ponder, but I think your explanation is a fair one. Does anyone take issue or want another nuance on that answer?

Mr. MACEY. No. I mean, I do not take issue with it. I agree. But I think, primarily, it would be, one, an issue of valuation. There might turn out to be no actual cash cost to it at all for the company. How does the company settle the options? Do they repurchase shares or is it out of treasury shares? And I think the main thing would be some transparency of disclosure, which is probably in the end, as I understand it, what you are probably alluding to, and I think that that either—right now, they do that through the footnote.

It probably belongs somewhere in a footnote or some other sidebar type of summary information because it does not seem like it really belongs in the profit and loss or balance sheet statements. Perhaps they need to upgrade the information that is in the footnote.

Mr. POMEROY. I thank you for your answer. We will look at that.

I was also interested in your comment, I completely agree with you that a 20-year-old is not a 50-year-old and a 3-year limit may have very different consequences one to another. Would it be an administrative nightmare to kind of take the administration's constructive idea and shorten it for older employees versus younger employees, 3 years for 20- through 35-year-olds, 2 years for 35- to 45-year-olds, and 1 year after that, or—I am just throwing that out as an idea.

Mr. MACEY. There is obviously a myriad and a vast variety of ways to expand mandatory diversification. Right now, in standalone ESOPs, it is 55 and 10. If you are age 55 and you have 10 years of service, you have some rights of diversification and they grow some over time after that.

Perhaps there needs to be some change in the rules, but I am not sure that one size fits all, and perhaps if there was just a minimum standard that said, for instance, if you have a certain num-

ber of years of service and a certain age, you have to have these diversification rights. But before then, the plan can make its own decisions with respect to diversification rights.

Maybe we do not hit the number right at 55 and 10. Maybe that number is not the exact right number, but perhaps something where there is a combination of age and service. It just seems like we need to account for the fact that there are employees with very different demographic factors in the work force. Employers want to at least have the employee have a relatively solid commitment to the firm before they are able to vest and/or diversify the amounts, and different plans are designed differently so that I would hate to see a requirement where we impose a single very inflexible and restrictive standard on everyone.

Mr. POMEROY. Mr. Chairman, my time is up, but I have got one burning last question. A few of you have indicated that we really need to work at keeping defined benefit plans out there as part of the array of options. Where would you put this 30-year reserving requirement issue that Mr. Portman spoke of? Is this an urgent matter Congress needs to attend, and if we fail to attend to it, will we discourage defined benefit plans that are already being offered? One word across the panel. Jim?

Mr. KLEIN. Yes, it is a very urgent matter. Companies that have been on so-called contribution holidays for the last few years, not really being able to make contributions, are now facing very large contributions.

Mr. MACEY. I agree. Using the current rates is an unrealistic economic measure of what the true liability of the plans are and, therefore, what the funding is, and the funding that the companies are required to put in under the current 30-year bond rates could be used for other things, like encouraging full employment and investment in capital and so forth.

Mr. LITTLE. One word, absolutely.

Mr. HOFFMAN. We would certainly agree. Yes, there is an urgent need to settle this matter and provide some stability in funding across longer time periods rather than being pegged to such a variable indicae.

Mr. POMEROY. It is a very astute panel, Mr. Chairman. I agree with everything they say.

[Laughter.]

Mr. POMEROY. Thank you very much.

Chairman HOUGHTON. Wise people. Mr. Johnson?

Mr. JOHNSON. Thank you, Mr. Chairman. You know, strangely enough, Mr. Pomeroy and I think pretty much alike, and I agree with you all. That 30-year bond rate, as you know, was fixed in two of our stimulus bills that the U.S. Senate is sitting over there holding, Mr. Daschle by name.

I was interested in your diversification ideas, Mr. Macey, but when we give a program like that to our staff, it comes out so complicated that we cannot understand it, and if we cannot understand it, surely you cannot either and neither can the employees and neither can it be implemented. We have got to have something simple and to the point. You never did answer the question directly, how much time is needed and is there any need at all? Can you not leave it to the employee if he is well advised?

Mr. MACEY. I do not know that I probably have a single correct answer. I have certain concepts in mind, that we need to balance the interests of employer and employee and we need to take account of the necessary security for employees and the right to diversify at some point in time.

All I can say is that we would be willing to have our experts work with the Committee and its staff in developing the right type of rule that would protect employees, satisfy the objectives of the plan from the employer's standpoint, and provide some flexibility so that it was relatively simple and easy to administer.

Mr. JOHNSON. You do not think the plan today is simple and easy?

Mr. MACEY. I do not think much about ERISA, in any case, is simple and easy.

Mr. JOHNSON. No, it is not. It has not been modified in a long time, and perhaps we need to look at ERISA. But ERISA does provide guarantees for our fiduciary, which everybody ignores the fact that in the Enron case, the fiduciary did not do their job, I do not think, and I think you will find probably Labor and Judiciary are going to get after them eventually. So that law is working, in spite of its complications. So how do you want to revise ERISA, if you want to change the subject, because you will not tell me what you want in this one.

Mr. MACEY. I guess, and I have been working with ERISA basically since it was enacted, and it has gotten more complex over the years. We have added additional layers. I think, one, just the regulatory regimen over defined benefit plans makes it very difficult for companies to make a decision to either adopt or, in certain cases, continue to maintain defined benefit plans and I think that, in my mind, over-regulation has hurt defined benefit plans——

Mr. JOHNSON. Do you think that is part of the reason people have gone to the 401(k) option?

Mr. MACEY. Oh, I think we would have had a lot of pressure toward 401(k)s anyway, but I think that we probably would have seen a lot more companies have 401(k)s as a supplement to a defined benefit plan rather than as the primary plan.

Mr. JOHNSON. So you suggest that we perhaps ought to change the defined——

Mr. MACEY. Well, the first thing, I mean, if——

Mr. JOHNSON. The benefit plan rules?

Mr. MACEY. I would love to see the defined benefit plans start to grow again like they did many years ago——

Mr. JOHNSON. So would I.

Mr. MACEY. Rather than decrease in number, and I think that is not going to happen unless there is relief and simplification on issues such as funding, on backloading, on discrimination testing, on giving more freedom to both employers and employees to make choices about what type of benefits they want and how those benefits should accrue over the years. What we have is a regulatory regimen that one size basically has attempted to fit all and it just makes it very difficult to live with.

Mr. JOHNSON. Yes.

Mr. MACEY. And I agree with——

Mr. JOHNSON. Do you not think the employees, though, sense that the 401(k) plan was a way to make money quick and get their benefits way up there? In the Enron case in particular, they saw the stock going straight up, so they are going to buy it. The Enron stock was not diversified, though. The company was not. It had one option. You have got companies like Procter and Gamble and General Electric that have a lot of their stock in employees' hands and yet their products are diversified, so you do not expect them to collapse overnight. I think that would require a higher fiduciary standard, perhaps, in the case of Enron than it does in those others because they are not diversified.

Mr. MACEY. We agree with you that fiduciary rules, as they currently apply, work pretty well and they impose a lot of fiduciary responsibilities on employer sponsors and those that they hire to run the plans.

Mr. JOHNSON. You made that clear in your statement. Thank you very much. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you, Mr. Johnson. Mrs. Thurman?

Mrs. THURMAN. Thank you, Mr. Chairman. Good afternoon. Thank you all for being here.

Mr. Macey, I have to agree with you. I was reading a *St. Petersburg Times* the other day, and it was talking about how Enron was sparking this huge debate, but one of the things that caught my eye is there really are a lot of different companies doing a lot of different things out there in these plans and some have them investing in their own stock, some do not, so there does seem to be some interest in not trying to disrupt everything but looking at where we might be able to go down the road, which brings me to an article that actually was written in the *Los Angeles Times.* I do not know if you saw it, but it certainly raised some issues for me about things that we might need to do, and some probably are going to seem pretty harsh, but I just kind of would like to hear your take on some of these issues.

A couple of things they talk about are while there should be diversification, there also should be disclosure, and I think the other one is some strong legal remedies that they believe are not in the law and at this time are not even being proposed. While some would believe that Enron employees, and quite frankly, any employee gets some kind of notice, talks about how good things are, how bad things are, whatever, but does not necessarily give us the best facts because they probably would have made the same decision based on that information they were receiving than what those folks that were selling at the top were doing.

So, one, I would like to hear a little bit more about how we might better give information, the same kind of information that others are getting to make sure that they can make good decisions, and I also would like to hear what you think about legal remedies in this. I can assure you that the constituency in this country is wondering why they are having to take the fall, why these—and I am sure we are going to hear from them, the Enron employees, why they are having to take it, why somebody else did not. I would certainly like to hear your take on that as to what you think we might

could do and should do to hold somebody responsible so we do not see these actions again. And that is to everybody.

Mr. KLEIN. If I could take both questions, the first one, in terms of disclosure, obviously, that is the name of the game. Therefore, I think some of the proposals that would require more frequent communications to participants and specifically talking about the importance of diversification, that is a real positive. The step that the House of Representatives took last year with respect to helping to facilitate more investment advice to individuals, and I would emphasize this is not the case of employers providing investment advice, it is helping them facilitate employees getting advice from knowledgeable professionals, is also a positive step. And I think the provision of the Portman-Cardin legislation that would allow people on a tax-deferred basis, tax-favored basis, to help finance obtaining advice from an outside professional is also a positive step.

With respect to the remedies issue, again, I can relate that best to my own personal experience as a fiduciary here. I think the rules are very strong now, as they appropriately should be. I know what I face in terms of civil and criminal liability and being removed as a fiduciary should I act not in the best interest of participants and beneficiaries and that is something very important.

And you are 100 percent correct, Mrs. Thurman, that the issue really is that the behavior of the individuals in the unfortunate Enron case might not have been different based upon the kind of information they were given. Fraud is illegal in all 50 States, and, therefore, the issue is, it seems to me, not should we be increasing liability on a plan fiduciary if there is an investment loss during this 2-week blackout period.

The issue is, were people who were in a capacity of authority misrepresenting the truth to other individuals and thereby falsely inducing them to either purchase stock or hold on to stock, and for all of that, there are certainly adequate laws on the books, Federal laws, State laws, and I do not think that you need to provide new causes of action on people as some of the proposals would do.

Mr. MACEY. I agree with what you have said, and I would like to supplement that a little bit. There are two types of, it seems like, disclosures and information that we are probably talking about here at today's hearing. One is that companies and their representatives who speak for the companies should tell the truth, and if that is not done, there should be penalties that they incur and that the companies incur and there should be recourse for failure to do that.

Mrs. THURMAN. Mr. Macey, do you believe there are today penalties for that?

Mr. MACEY. I do. I do.

Mrs. THURMAN. In today's law?

Mr. MACEY. Yes. In fact, the Supreme Court has, in a decision which I think I cite in my written testimony, *Varity v. Howe,* has indicated that those who speak on behalf of the company and intend to influence plan participant decisions have to tell the truth, and if they do not tell the truth, they will be held liable to the plan and the participants.

The second type—and the accounting standards and things like that need more understandability and transparency. It is some-

thing well beyond my kin to understand, but I read reports in newspapers that say that even experts do not understand certain things about the accounting standards and how you reflect different balance sheet and profit and loss type issues.

The second type of information is, I think, the one that at least somewhat would have been helpful to Mr. Pressman from Enron that Mr. Coyne referred to, and there is nothing sanguine I can say about his situation. It is a personal and tremendous human tragedy that he and other Enron employees have lost a significant part, or in some cases all, of their retirement security.

However, most of what he had in his account, and others, during their employer years was subject to diversification. There was no restriction on it, as I understand the plan. And then after a person's retirement, even in the Enron situation, a person could fully diversify.

Unfortunately, two things were probably at work there. Number one, it appears that the senior management of Enron was touting to their employees and potentially their retirees the merits of continuing to invest, potentially heavily, and not diversify into other things. I do not know that to be the case, but that is the implication about what I read a lot about and hear in the press and on the TV.

The second thing was what we need is investment education and advice, and right now, employers are either prohibited or discouraged from doing so because of the possible imposition of liability on things that they or their vendors and investment managers may say about it. If the Enron participants, especially those later in their careers and during retirement, had that access to advice, I think maybe a lot of them would have made different decisions about how they invested their money.

Chairman HOUGHTON. Mr. Foley?

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

Your comments have been very, very appropriate and I appreciate our taking time to hear what you have to say because it is always my fear that when there is an upheaval or a singular event like Enron, we in government or in politics try and find a multitude of ways in which to spread or push the blame off of us and create and attempt to change laws.

My colleague in the Senate, Mr. Corzine, has a proposal that would limit an employee's ability to invest in their company to 20 percent. I kind of find that shocking, and I am not criticizing Mr. Corzine, but I am certain his wealth that he accumulated in the years on Wall Street is largely probably of Goldman Sachs partnerships. So he had the chance throughout his working life to take pride in his company, believe in his product, accumulate assets and wealth because of his hard work.

And now because of one debacle, one serious, what I consider criminal behavior of a corporation, we are now going to unravel every rule and start trying to insist that employees can only have a certain piece of their portfolio in their own company, which I think undermines the free enterprise system. Many employee stock ownership companies are successful because the employees are partners. They want to see the bottom line work for themselves, the shareholders, and personally, their own retirement.

So I was particularly interested, Mr. Klein, you said, and so did Mr. Macey, about education, and we had this debate on the floor a few weeks ago. I know as I am investing in my 401(k) in the U.S. Congress, every Member has a chance now to select from five different vehicles. Each one carries with it its own risk, its own potential windfall or, potentially, loss. It clearly describes that.

The point that I am getting to, and first, Mr. Macey, you mentioned in the case of Enron many employees experienced debilitating losses in their retirement accounts because the stock comprised a significant portion of that account, that stock. But do you believe in the approach Mr. Corzine and others have where they would limit or impose a limit on the employees' ability to hold stock in the company?

Mr. MACEY. No, I absolutely do not because I think that the 401(k) system and the ability to invest in your own employer's stock has created millions of secure retirees across the country and secure employees looking toward retirement and I think that education—artificial limitations, I do not think, work. We would take away—and the perverse thing about it would be that people who work for the most successful companies that have done so well on the stock market and are run so well, they would be the ones hurt the absolute most.

So it just seems to me that—I understand the superficial appeal for it because we have all looked at Enron and we say, gee, it is a terrible situation and we need to do something and we have human tragedies here, but I truly think that disclosure and transparency and maybe some liberalization of the rights to diversify the employer's contribution makes sense. But artificial and arbitrary limitations do not.

Mr. FOLEY. Mr. Little, you mentioned in your written testimony that last year, your company stock provided a better return than the other eight investment alternatives. What are the other eight alternatives, briefly?

Mr. LITTLE. They range from a very low-risk all-government securities fund to a regular bond fund to a standard & poor's, S&P, index, fund to a sort of mutual fund that has a blend of assets. So if the associate does not want to make their own investment allocation decision, there is a fund that does that for them.

Mr. FOLEY. Education, for the employee to be able to get education, that is right now a very difficult aspect. You mentioned liability. So you strongly recommend that approach?

Mr. MACEY. I recommend, yes. Education and the fact of giving employees the choice to take some tax dollars on a pre-tax basis and use it to purchase independent advice, to free up investment managers and the employers to provide education and advice, and if it is the investment manager, if there is any issue about them potentially touting their own funds, I think that that should be fully disclosed, that they have potential conflicts. But these are the experts. They should be able to talk to people who invest in their funds.

Mr. KLEIN. On that point, therefore, the House of Representatives wisely, in passing the legislation introduced by Congressman Boehner last November, addressed precisely that issue of disclosure and making sure that potential for conflicts of interest could be

avoided and protected against in that way. And one of the real anomalies is that if I am an employer and I want to go to my investment service provider, they can provide all sorts of different services for me. But the one thing that they really cannot do under current law is get engaged in that kind of investment advice, where they could really be helping the participants of the plan that I sponsor for my colleagues. We need to somehow get over that hurdle and provide the transparency that Mr. Macey talks about, but let people get the information they need to avoid costly mistakes.

Mr. FOLEY. I think we can make progress. If we work on things like blackout periods and things where the employees were arbitrarily held aside while the others were able to golden parachute out of the problem, I think those are areas that are significant. I think if Congress would review the kind of off-balance sheet items that were occurring in Enron, side partnerships that were not recorded, that seems to be the crux of the problem here. I do not think we should penalize hardworking employees by taking away abilities to secure their future retirement simply because a few people in Texas decided they would break the rules and bend the rules. So I appreciate some of the wisdom today.

Mr. Hoffman, did you want to respond?

Mr. HOFFMAN. The one point I would make, many plan sponsors are reluctant to get actively involved in providing investment education to their employees for fear that they are going to assume fiduciary liability for the advice being given by the investment advisor, and so we certainly want to encourage education to be provided to employees and we think a very, very critical element of that is the waiver of liability for a plan sponsor who engages a qualified investment advisor, that the employer plan sponsor should be shielded from liability and that is the best vehicle to get that advice out to the employees themselves.

I believe the President alluded to that in his proposal and I believe that is part of the proposal in the Senate bill sponsored by Senators Bingaman and Collins and we are very supportive of that provision.

Mr. FOLEY. That investment advisor has to be arm's length, I would assume, because you cannot give a blanket liability waiver if you as the employer are advising the investment firm as to how best to——

Mr. HOFFMAN. In my understanding, the Bingaman-Collins bill has specific criteria by which the investment advisor, if chosen prudently, would fit within that exemption. So there are limitations on who can be picked for that purpose.

Mr. FOLEY. Thank you.

Chairman HOUGHTON. Mr. Rangel?

Mr. RANGEL. Mr. Houghton, Mr. Chairman, first, let me thank you for chairing these hearings, and my colleague, Mr. Coyne, for not only chairing the hearings but the sense of fairness and bipartisanship that you demonstrate on the floor you have brought to the chairmanship, and I want to thank you for it.

I wish I could say the same thing for my colleague from Florida that went out of his way to single out a Democratic Member of the other body, but I am certain he would not have done that if we were not on C–SPAN. But the House rules do not allow us even

to refer to the other body by name, so it would seem to me that if it is wrong to do it on the House floor, it would be equally as wrong to single out somebody that in no way can defend himself.

But the strange thing about all this, Mr. Chairman, is his defense of Enron. The reason I say it is that you went out of your way in your opening statement to say that today's hearing is not about Enron. As a matter of fact, the Chairman of this Committee refused to have the full Committee take a look at Enron. So I can understand the sensitivity of the Republican gentleman from Florida about Enron, but I hope that notwithstanding the Vice President's position on sharing information that you not look at this as a partisan thing. It is just a few people in Texas having broken the rules, as the witnesses have said.

Our responsibility, since we provide the incentives for people to get involved in defined contribution plans, is not only to set the rules but to provide a moral, legal, and fiduciary responsibility to see that these rules are maintained or to change them if we find abuse.

Now, I assume that the Chairman did not allow the full Committee to investigate this because he does not believe in investigation or he thought it would be embarrassing, but I think the witnesses have clearly demonstrated that if you find something broken one place, try to remedy it before we have adverse reaction someplace else. I am confident that the investors that lost are Republicans and Democrats and Independents, and so our responsibility is not to look at this as a political issue but to see what our responsibility is and our involvement is as we continue to move forward to taking government out of the lives of people and allowing them to make their own decisions, whether it is a winner takes all, no guarantee, just go to the stock market, whether we privatize Social Security, or whether we take away guarantees with the moving away from defined benefits.

So, Mr. Houghton, so far, I have not looked at this as a political issue, but if the gentleman from Florida believes I should take another look, then perhaps there could be some implications, but we do not have that information yet because the Vice President will not surrender it. There may be reasons that you may have to know why we should not even talk about it, but talking about this is not a party issue. Talking about this is a Congressional issue, it is a Ways and Means issue, and if Chairman Houghton had not brought this up with the cooperation of Mr. Coyne, this Committee would have forfeited its responsibility to provide oversight.

Now, we do not mind taking on the IRS and demoralizing them and pointing out what they have done wrong. We do not mind taking on lawyers and accountants. But we share equally in the responsibility that we have to the employees if we do not provide the oversight.

So I want to thank you for allowing me this opportunity, and if the gentleman from Florida has reason to believe that this issue is political, then we can take that up in the campaigns that we will have in November. But right now, this should be a bipartisan issue and that is the way I look at it. I do not think that any Republican Senators or any Democratic Senators have anything to do with this hearing. Thank you.

Chairman HOUGHTON. Thanks, Mr. Rangel. The time is up, and we want to move along here, but do you have a specific question?

Mr. RANGEL. Do you think that it serves any worthwhile purpose for us to provide oversight and to find out what your views are as to what we can do to perfect the retirement system for Americans throughout these United States? If there is anyone who disagrees, with that, will you please raise your hand?

[No response.]

Mr. RANGEL. No, I do not have any questions. Thank you.

Chairman HOUGHTON. Evidently, there are not any answers, either. Ms. Dunn?

Ms. DUNN. Thank you very much, Mr. Chairman.

Gentlemen, I am glad you are here today. I have enjoyed hearing your responses to several of these questions and particularly with regard to financial literacy, which is a term I have just begun to hear in the last few months and I think is so terribly important.

My concern about all of this is that I do not want us to become anecdotal about some of the new restrictions we provide on people's ability to choose how they invest their dollars. I have great sensitivity, as we all have, for the folks involved in the Enron tragedy and certainly we never want that to happen again. But I think I have perhaps greater concern for our legislating out of crisis, and I think we have to be very careful to be thoughtful and to do our research properly before we make legislative changes that might over-regulate an industry that, in general, seems to be doing pretty well.

I have a couple of questions I would be interested in knowing your positions on. We know, for example, that in current law, defined benefit pensions are insured by the Pension Benefits Guaranty Corporation There has been a lot of talk in the last few weeks about including defined contribution plans under the same umbrella as a way of protecting 401(k) retirement assets, and I would like to know your opinion on how this guarantee would affect investor behavior. For example, would this not just inspire people to make riskier investment decisions? So I would like to have your thoughts on that, and perhaps as an extension, if we are going to do that to 401(k)s, what about IRAs?

Mr. KLEIN. I think that trying to guarantee defined contribution plans would be a very bad idea for a number of reasons. You identified one in terms of having the sort of anomalous result of perhaps making people even be riskier in their activity as sort of the moral hazard of that insurance being there.

Second, it is really anathema to the whole concept of defined contribution plans to—I mean, what is it that one would be guaranteeing? Would you be guaranteeing market risk here, that the stock would go down? At what point would somebody invoke their ability to collect this insurance, when the stock goes from $80 to $26 or to 26 cents? I think that is why we have a defined benefit pension plan system, and there is a lot more, as we talked about earlier in the hearing, that Congress could do to help support the growth of those kinds of plans. Each type of plan has its own role in the retirement system.

I think that, two other final points to note. Certainly, just about every 401(k) and other type of defined contribution plan has as an investment option some guaranteed type of investment choice that at least provides some basis of security. And moreover, I would say that this is a real opportunity to appreciate once again the value of so-called hybrid plans, cash balance plans, and other plans of that nature, and I think that this point sort of relates to, as an answer to a number of the questions that have been posed today, which is there is the kind of a plan that provides the guarantee and the security of a defined benefit pension plan—it is a defined benefit pension plan—but it has features of it that resemble a defined contribution plan in terms of the growth, and I think that Mr. Hoffman's comment about his DBK plan is probably something along the lines of a hybrid plan.

So for all of those reasons, I think the idea of trying to guarantee a defined contribution plan would be ill advised.

Mr. LITTLE. I think, also, you pointed out the importance of financial literacy, and I think one of the most significant elements in that over the past decade has been the evolution and increase of 401(k) plans. And to put maybe some regulatory insulation around that and make it less within the control and sight of the new shareholders we have created would be a step maybe away from that literacy that we have created. So I think that you have to look at that guardedly.

Mr. MACEY. And there is a cost to any type of insurance, and I know there is some debate publicly about it and some people have written articles and others have testified about it, but I tend to accept, based upon experience and common sense, that the costs of that would probably be 25, 35 percent of a typical return over time. So to me, it just does not make a lot of sense to turn an entire plan into effectively a guaranteed interest contract, especially when there are generally fixed income vehicles available for people to invest in.

And although the system is not the perfect one and there is some risk to it, it kind of reminds me of what Winston Churchill said about democracy. He said it was the worst form of government except for all others.

Mr. HOFFMAN. I would certainly echo my co-panelists' comments that having an insured defined contribution plan, I think, potentially would be expensive at best. A potential moral hazard if a participant were given the choice as to how to invest their account knowing full well there was some minimum level that they would always receive, I think gives folks perhaps too much leeway.

Frankly, I think that the financial education aspect of it is the most critical because the defined contribution plan, if one looks in a long-term investment mode and does not react to the year-to-year cycles but looks at a 20-year window, I think the need for insurance is really not there, that a well-balanced diversified portfolio will provide a market rate, if not better, return for folks following standard investment portfolio type theory.

So we believe, again, that the vehicle for providing insured benefits is the defined benefit plan, and we would like to see more effort focused on revitalizing those plans, finding ways to make them

more attractive to employers and employees, and where the structure is already in place, to provide those guaranteed benefits.

Ms. DUNN. Do I have time for one last question? This is sort of self-serving because it has to do with some pretty happy folks in my hometown, Microsoft employees. I just want to read from you, how would mandatory diversification, if that became a requirement, how would that work on an ESOP? The district that I will be representing after this next year's election includes the corporate headquarters of Microsoft, and they have provided pretty well for their employees. I have some concerns about what has been in most cases thus far, at least, a very successful vehicle for wealth creation, and what you think about that sort of a requirement.

Mr. HOFFMAN. Let me first interject that when we are talking about an ESOP in particular, when we are talking about a non-elective type contribution ESOP, where the money going in is not employee deferrals and not matching contributions. I believe it would not work very well to have any mandatory diversification. I think, again, Congress over the last 20 years has recognized the benefit of giving employees a stake in the business enterprise and if it is provided on a non-elective basis, I do not believe there is any need or mandate to require diversification.

Now, one can make the case when it is employee money, certainly, and even matching contributions, as well. But I think, as you point out, there have been many, many success stories over the last 20 years of employees who have benefited greatly from being invested in employer stock. They know better than anybody what is going on with that company.

So in a non-elective ESOP, I personally do not believe and my organization does not believe that that would work well at all, frankly.

Mr. MACEY. The code is the body that authorizes ESOPs, and it says that they have to be designed to primarily invest in employer securities. So the whole regimen about the regulation and design of such plans would have to be changed. But even if that was done, as a practical matter, we are talking about employer contributions, effectively, because employee contributions in 401(k) plans, and there are not too many stand-alone ESOPs that have employee contributions, are under a different regimen where there is already mandatory diversification rights under the provisions that were sponsored by Senator Boxer a number of years ago.

It just seems like in a stand-alone ESOP or in an ESOP which has matching employer contributions where the employer is contributing the full amount, that perhaps some liberalization of the current rules now of 55 and 10 are in order, but not too significant because these plans are established for a number of purposes, including business purposes, and if the business purposes are undermined, it just seems like the employers are no longer going to be committed to adopting and maintaining and making generous contributions to these plans.

Mr. KLEIN. I guess I could only add to that that we have a lot of member companies in our organization who permit very rapid or immediate diversification, and I think we can all applaud those companies that choose to do it. But that does not mean that those

companies that do have a required holding period for some period of time for some reason, to age, to length of service, until the person departs the company, that they, too, do not have a legitimate business reason for wanting to have that kind of a requirement, and these are, as my fellow panelists have pointed out, these are the employer contributions that we are talking about.

Chairman HOUGHTON. All right, Ms. Dunn.

Has anybody on the panel got any other questions, any other statements you want to make? If not, we want to thank you very much for your help here, and I would like to call the second panel.

Chairman HOUGHTON. There are six Members of the second panel. Mr. Richard Trumka is the Secretary-Treasurer of the American Federation of Labor-Congress of Industrial Organizations. Dary Ebright is a Special Tester at Portland General Electric Western Division of Enron, and a Member of the International Brotherhood of Electrical Workers. Deborah Perrotta is a former Administrative Assistant of Enron in Houston. Cecil Ursprung is chief executive officer of Reflexite Corporation in Avon, Connecticut. Delores Thomas is President of Ewing & Thomas in Port Richey, Florida. Karen York is an Accountant of Scot Forge Company in Spring Grove, Illinois, and she hails from Sharon, Wisconsin.

I would like to recognize Mr. Paul Ryan.

Mr. RYAN. Thank you, Mr. Chairman. I appreciate it.

Mr. Chairman, I just wanted to take a moment. I am not a Member of this Subcommittee but of the full Committee. I want to take this moment to introduce to you a constituent of mine, Karen York from Sharon, Wisconsin. Karen is here to testify on behalf of the ESOP Council. She works at Scot Forge, a company in Clinton, Wisconsin, which is near Sharon, but also very interestingly, Karen used to be an ostrich farmer.

[Laughter.]

Mr. RYAN. We have actually a handful of ostrich farmers in Wisconsin, and it is a pretty interesting profession. It was one of your hobbies, right, Karen?

But in all seriousness, Karen has extensive experience working in the ESOP area. She served on the Scot Forge ESOP Council for 13 of the 15 years she has been a staff accountant at Scot Forge, but also, she served three terms on the ESOP Association's Board of Governors. In 1998, she was named Employee Owner of the Year by the Illinois Chapter of the ESOP Association. And then she went on to gain some national recognition, where she earned the National Employee Owner of the Year Award from the National ESOP Association.

So I just wanted to introduce Karen York from Sharon, Wisconsin, to you, and just to let you know, you have got somebody who really knows what she is talking about with real-life experiences.

So thank you, and I yield back the balance of my time.

Chairman HOUGHTON. Thanks very much, Mr. Ryan. Mrs. Thurman?

Mrs. THURMAN. Thank you, Mr. Chairman.

Mr. Ryan, we have ostrich farms in Florida, as well, and so I have the distinct honor to introduce Ms. Thomas, who obviously has worked well with Ms. York over the years, but it has not been

on ostrich farms. It is probably Ms. Thomas probably works on those who have been working on ostrich farms because she is a physical therapist but has an ownership and is also an ESOP and certainly is well recognized by the ESOP organization as she served as the past President of that organization and, I think, did a fine job in bringing these issues to Congress and has in the past. We always appreciate Dee and her group.

I have to tell you, I was with these folks just a couple of weeks ago in St. Petersburg for their Southeastern conference and they are very concerned, and I think you will see in the testimony that has been submitted, there has been a letter put in here that really sums up a lot of their feelings, and the fact that they want us to move slowly, they do not want to have their organization dismantled, that they believe that they provide a wonderful partnership with their employees, and I can assure you from talking to the employees that work with Ms. Thomas that they are very comfortable with the way things are going and certainly do not want this disrupted.

Dee, we are so pleased to have you here, and Ms. York, as well. Thank you.

Chairman HOUGHTON. Thank you very much. Ms. Thomas, I have got a question for you. I know that pensions or ERISA rules do not really apply to ostriches, but can you do physical therapy on ostriches?

Ms. THOMAS. I doubt it.

[Laughter.]

Chairman HOUGHTON. What I would like to do now, Richard, the floor is yours.

STATEMENT OF RICHARD L. TRUMKA, SECRETARY–TREASURER, AMERICAN FEDERATION OF LABOR–CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. TRUMKA. Thank you, Mr. Chairman. I am not an ostrich farmer, but I did take my head underground several times in the coal mines.

Good afternoon, Chairman Houghton and Ranking Member Coyne, Members of the Committee. My name is Rich Trumka, and I am Secretary-Treasurer of the American Federation of Labor-Congress of Industrial Organization (AFL–CIO), and on behalf of the AFL–CIO and our 13 million Members, I want to thank you for the chance to appear here today.

When the House Financial Services Committee held the first hearing on Enron, the AFL–CIO testified that Enron's collapse was due to a combination of factors, first, an unaccountable group of self-interested executives, and second, the complete failure of all the structures that are supposed to protect investors and employees. Enron's collapse showed how pervasive the structural conflict of interest in our capital markets and pension system are and how harmful they can be to workers and investors.

Every revelation since has only further highlighted the need for immediate reform of our capital markets and retirement system. Workers' retirement security should be financed by a three-layer pyramid. The base is Social Security, and surely what happened at Enron should spell the end of the idea of putting Social Security

at risk in the capital markets. The next layer should be a defined benefit plan. And the top layer is personal savings, most importantly in the form of tax-favored 401(k)s and similar plans.

Today, I will speak to the need for reform in 401(k) plans, an issue that is within this Committee's jurisdiction.

Too many employers use workers' retirement savings as a corporate finance tool. Employers combine their ability to make the employer match entirely in a company stock, with workplace campaigns to pressure employees to place their own contributions in employer stock, like what we saw at Enron. As a result, workers' retirement money is perilously concentrated in one stock.

The Committee is hearing today from representatives of a number of firms that are very pleased with their use of company stocks to finance worker benefits and the AFL–CIO agrees that a traditional ESOP can be an appropriate supplement. A pro-worker ESOP should be a supplement to a defined benefit plan governed by worker trustees. But the employer who provides no retirement plan other than one funded by employer stock is simply not acting in the workers' interests.

The AFL–CIO supports wide-ranging reforms in 401(k)s to address the policy failings that led to the devastating impact of Enron's collapse on its worker retirement security. First, workers should have the right to sell company stock in their defined contribution retirement plans immediately. But just giving workers a right to sell is not enough. To be effective, any reform must address efforts by employers to encourage and induce workers to invest heavily in company stocks.

Companies should be given a choice. If an employer does the right thing and provides the employees with a good enough defined benefit plan, and surely Enron gave Ken Lay a good pension, the employer should be allowed to make its 401(k) contributions in company stock and offer that stock as an investment option. But if an employer insists on just having a 401(k), then it should not be allowed to do both—either, but not both.

Workers should also have a right to independent investment advice. The House has passed a bill that would remove ERISA's protections against conflicted advice from money managers, a bill that President Bush endorsed as a solution to the problems of Enron. But after Enron, the last thing we need to do is create more chances for companies, be they employers or money managers, to exploit 401(k) participants.

Finally, we should learn from Enron that employers have many ways of managing 401(k)s to suit their interest rather than the workers. We need to empower employees to counter the conflict of interest involved in exclusive employer control of 401(k)s. We strongly support Representative Miller's proposal to require equal worker representation on 401(k) boards. Joint trusteeship gives workers a voice and empowers outside experts who are no longer solely beholden to the employer and are so better able to truly give independent advice.

In conclusion, Enron was not an aberration. It was just not about one or two rogue executives. Enron was just what its executives and its boosters in the press said it was, one of America's leading companies and it was leading us down the road to ruin. It took ad-

vantage of conflict of interest that had been allowed to grow unchecked in our capital markets and retirement policies that allowed employers to use workers' retirement savings as their corporate piggy bank.

The labor movement supports comprehensive reform of our capital market and our pension laws. On both sides of the aisle, there are those who understand that there must be change and are ready to act. Mr. Chairman, America's working families and their unions are behind that effort 100 percent and the AFL–CIO stands ready to assist this Committee in that process. Thank you, sir.

[The prepared statement of Mr. Trumka follows:]

Statement of Richard L. Trumka, Secretary-Treasurer, American Federation of Labor-Congress of Industrial Organizations

Good Afternoon, Chairman Houghton, Ranking Member Coyne, members of the Committee. My name is Richard Trumka, and I am the Secretary-Treasurer of the AFL–CIO. On behalf of the AFL–CIO and our unions' 13 million members, I am grateful for the opportunity to express our views on the Enron debacle, its impact on Enron workers and the much broader implications it has for retirement security.

The Labor Movements Response to Enron's Collapse

First, let me begin by briefly describing what the AFL–CIO has been doing since last fall in response to the collapse of Enron. In December, when the House Financial Services Committee held the first Congressional hearing on Enron, I testified before that Committee that Enron's collapse was due to the combination of the actions of an unaccountable group of self-interested executives with the complete failure of all the structures that are supposed to protect investors and employees. I said at that early date that Enron's collapse showed how harmful the structural conflicts of interest in our capital markets and our pension system were to workers and investors. Every revelation since December has only further highlighted the need for immediate and systematic reform.

Since then, the AFL–CIO has provided direct assistance to workers, including joining with laid-off Enron employees in seeking—and winning—severance payments. Long before Enron was a household word, the AFL–CIO and worker pension funds took steps to try to reform corporate governance and disclosure at the company, and then as the situation worsened to protect workers' investments in the courts. As the fate of the company and the reasons for its demise became clear, we filed petitions with the SEC designed to ensure greater independence of auditors and of company boards. We have been taking the lead in demanding that members of the Enron board of directors not be renominated from the more than twenty companies where they continue to sit in positions of fiduciary responsibility. Finally, the AFL-CIO and union pension funds have been active in the corporate governance process seeking to ensure that boards of directors, company auditors and Wall Street analysts are independent.

The Devastating Effects on Workers

Today, you will be hearing from the very people who have been affected the most personally and painfully by the Enron debacle, Enron's workers. Deborah Perrotta and Dary Ebright are two Enron workers who worked for different divisions of Enron's far-flung corporate empire. Deborah and Dary have much in common, not only with each other but also with workers all across America who have been financially devastated when their companies collapsed and took their worker's retirement security down with them.

Although shareholders at Enron, including millions of America's working families and their pension funds, lost tens of billions of dollars, individual Enron workers have suffered the greatest damage. Thousands of them now find themselves with 401(k) retirement accounts worth just pennies on the dollar because their accounts were heavily invested in Enron stock. Workers who thought they had secure retirement investments valued at hundreds of thousands of dollars, or more than a million dollars in some cases, are heading toward retirement with just several thousand dollars in savings. Not only are their paper profits from inflated stock prices gone, but so too are their hard-earned wages that they contributed from each paycheck, thinking that by sacrificing today they were building a secure retirement for tomorrow.

Union members are among those Enron workers who were hit hard. As Bill Miller, Business Manager and Financial Secretary of IBEW Local 125 in Portland, Oregon, told the U.S. Senate Committee on Governmental Affairs in February, just eight of his members who work at Enron's Portland General Electric subsidiary lost nearly $2.9 million. One of them was Tim Ramsey, a 57 year-old lineman with 35 years of service, who had to put off his plans to retire next year when he lost over $985,000 in his Enron 401(k). Many more of the more than 900 active employees and 550 retirees represented by Local 125 lost money by investing their hard-earned retirement savings in Enron.

Many of the non-union workers based at Enrons Houston headquarters have been hit even harder. Thousands of those Enron workers have lost their jobs and along with their jobs they have lost their health insurance, dental insurance, and life insurance. On top of all that, many of them have seen their hard-earned retirement savings go up in smoke.

Digna Showers, an 18-year Enron employee who worked as an administrative assistant in the Logistics Department, was laid off last December 3rd. Her family's primary wage earner, she lost her savings in Enron stock, which at its peak was valued at more the $400,000, invested through her 401(k) and ESOP. Today, she is struggling to keep her family's finances together and most importantly to pay for the medical care and medication that her husband, a disabled former schoolteacher, urgently needs.

Ms. Showers, like more than 5,000 laid off Enron workers, has not received the severance money she was promised because she was laid off the day after Enron declared bankruptcy. In contrast, Enron arranged to wire $55 million in "retention bonuses" to a handful of executives on the last business day *before* Enron filed for bankruptcy. The AFL–CIO is supporting the efforts of the laid off Enron workers to have their severance paid now. We have had to fight both the new management of Enron and the big banks on Enron's Creditor Committee like JP Morgan Chase, Wells Fargo and CS First Boston. These banks seem happy to pay hundreds of millions in gratuitous bonuses to a few executives but have a problem with paying to thousands of people merely what they are owed—people who as a result of their commitment to Enron find themselves in desperate need.

I should note that it is a scandal that our bankruptcy laws allow this sort of conduct by a debtor company. The AFL–CIO supports changes in the bankruptcy laws that would protect workers and their benefit funds, while we oppose the current bankruptcy bill that essentially benefits those same banks that are trying to deprive Enron workers of their severance.

The speed with which the Enron workers' retirement savings evaporated is shocking to everyone, but the fact that it happened at all should not be surprising. The same thing happened to workers at companies like Color Tile and Carter Hawley Hale in the 1990s because their retirement plans were heavily invested in company assets and is happening to other workers today at companies like Global Crossing and Lucent.

The harm Enron's collapse has caused America's working families by no means stops there. Workers' retirement funds have lost tens of billions of dollars in the collapse of Enron. Earlier this year, Enron was the 7th largest company in America measured by revenue. Enron's equity at its peak was worth about $63 billion, and its bonds another $6 billion. There was almost twice as much money invested in Enron stock as there was in General Motors stock. Most pension funds and institutional investors held some Enron stock or bonds. If any person in this room has an S&P 500 index fund in your 401(k), Thrift Savings Plan account, or IRA, you lost retirement money in Enron—probably about a half a percent of your total assets in that fund. And this is if you invested in index funds—in a strategy designed to mitigate cheaply the risks of investing in any single company.

The Enron Debacle and Retirement Security

Enron is not simply a case of a single company gone bad: It is a broader story about risks and losses for workers who play by the rules. The Enron bankruptcy has exposed major vulnerabilities in working families' retirement security. It has raised public questions about defined contribution retirement plans. And it has focused attention on the threat posed by proposals to privatize Social Security, which would trade in some or all of the system's guaranteed benefits for individual accounts like those held by the workers at Enron.

The labor movement feels very strongly that retirement security is best financed by a three-layered pyramid. For most, at the base is Social Security. The guaranteed defined benefits of this family insurance program are the bricks and mortar on which retirement security is built for almost every American family. The next layer should be a defined benefit pension plan—plans that provide a guaranteed benefit

financed by professionally managed funds, behind which stands the guarantee of either the Pension Benefit Guaranty Corporation and ultimately the United States Treasury, or the sponsoring state or local government. And the top layer is personal savings—most importantly in the form of tax-favored defined contribution benefit plans like 401(k)'s—savings that varies based on employees' surplus income and that is at risk in the markets but that still needs to be managed based on sound investment practices and protected against employer manipulation.

The objective of having a diversified portfolio of retirement income sources is to make it reasonably certain that workers will be able to retire after a lifetime of hard work and to sustain in retirement the same standard of living they had during their working years. Workers need Social Security, a pension and retirement savings to achieve real retirement security.

Social Security

As we have said all along, real retirement security begins with a strong Social Security system that provides working families with guaranteed defined benefits. The Enron debacle has important implications for the debate over Social Security's future and particularly for proposals to privatize Social Security by replacing all or part of its guaranteed defined benefits with private investment accounts.

First, Social Security's guaranteed defined benefits become even more important if workers' supplements to Social Security—their job-based retirement plans and personal savings—can simply evaporate in a matter of months. That this can happen—and that national retirement policy as embodied in ERISA and the Internal Revenue Code not only condones but encourages retirement plans in which this can happen—reemphasizes the importance of a secure foundation for retirement security. The risk to workers' retirement savings is even more troubling when you consider that plans to privatize Social Security invariably result in large cuts in Social Security's benefits—both guaranteed benefits and total benefits even after counting the new individual account plans.

The President's Social Security privatization commission tried to fudge this issue by assuming that trillions of dollars would flow into the Social Security system from the rest of government to cover the huge transition costs required to fund the commission's costly proposals. But the prospect for this happening is dubious given the rapid deterioration of the federal budget outlook for both the short and long terms during the Bush Administration. As a result, retirees, disabled workers and surviving spouses and children will face severe reductions in Social Security benefit amounts in the future. Also, part of their benefits will vary greatly depending on the performance of the financial markets.

Second, a privatized Social Security system will, sooner or later, allow workers to invest in individual stocks. Yes, privatization advocates have been quick to point out that their plans would limit workers' investment choices to diversified investment options. Even if they are sincere about these claims, however, it is difficult to see how these assertions are grounded in reality. A representative of the Bush Administration, appearing before the full Ways and Means Committee just last month, declared that "[e]mployees who determine their own investment goals do not want a government to restrict the amount of their investment that can be invested in specific funds."[1] If you believe this is true for private job-based retirement plans, then you must also believe that workers will feel just as strongly about privatized individual accounts that replace Social Security benefits. A privatized Social Security system eventually will become part of employers' campaigns to use their employees' retirement savings as a corporate finance tool—it will just be a matter of time.

Pensions and Savings

Social Security is the critical base for workers—nearly two-in-three older Americans count on it for half or more of their income—but it does not provide nearly enough to maintain working families' pre-retirement standard of living. Workers need something more. We believe that something must start with a real defined benefit pension and should be supplemented by defined contribution savings.

When workers have Social Security and a defined benefit pension plan, they can afford the risks involved in having a defined contribution supplement. But when workers have no defined benefit plan and only a defined contribution plan, they are at risk of a catastrophic loss. This is a risk most workers cannot bear, and which tragically tens of thousands at companies like Enron, Lucent, and Global Crossing have all experienced in the last several years.

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[1] Statement of the Hon. Mark Weinberger, Assistant Secretary for Tax Policy, U.S. Department of the Treasury, before the House Committee on Ways and Means, hearing on "Retirement Security and Defined Contribution Plans" (February 26, 2002).

Unfortunately, over the last twenty years, employers and policy makers have together worked to collapse the three layers of retirement security. As a result, many workers have to rely only on Social Security and their personal savings, savings that are fully at risk in the capital markets.

Defined benefit plans by their very nature require employer cash contributions. If a defined benefit fund has losses in its investment portfolio, employers must make up the shortfall. Naturally, employers have come to prefer 401(k) plans. In these plans, when there are market losses, the employee bears all the risk and has lower benefits.

Many employers are using worker retirement savings as a corporate finance tool. Employers can make their contributions to workers' individual accounts entirely in company stock, a practice barred by ERISA's 10 percent limit on employer securities for defined benefit plans. When employers make their contributions in stock, it is a cash-positive transaction for the company as there is no cash cost to the employer and the employer is able to take a tax deduction for the contribution. Furthermore, as the law stands now, employers can force workers to keep part of their accounts funded by employer contributions invested entirely in company stock.

When employers completely control the management of 401(k)'s and other defined contribution plans, they act on these perverse incentives to make workers' retirement savings imprudently diversified. Employers combine their ability to make the employer match in company stock with workplace campaigns to pressure employees to place their own contributions in employer stock. Campaigns that we saw at Enron included pitches by senior officers through email and in person and the use of company newsletters to encourage workers to concentrate their retirement assets in company stock. Great for the bottom line of the company, but not so for the individual plan participant.

The Committee has heard today from a number of firms that are very pleased with their use of their own stock to finance worker benefits. I suppose one could say their testimony is proof of my point—employers love to put their employees' money at risk in their stock. But it is important for this Committee to understand the different implications of different uses of employer stock. For example, the employer who provides no retirement plan other than one funded by employer stock is simply not acting in their employees' interest. They are asking their employees to stake their well being in retirement on only one stock—it's akin to putting all your money on a single hand in a card game.

But an ESOP or other employee stock plan makes sense as a supplement to a defined benefit plan and a properly diversified defined contribution plan, or as a medium term investment. Union sponsored ESOPs typically have this structure—they are supplements to defined benefit plans whose objectives are job preservation, worker voice, and medium term investment returns. This type of ESOP can have the positive attributes the employer witnesses here have discussed while workers' retirement security remains in the hands of properly diversified plans. As I will discuss further below, Congress needs to act to protect workers from employers who are more interested in their corporate finance goals than in their employees' retirement security, while continuing to support the proper use of ESOPs and other employee stock ownership vehicles.

An Agenda for Action to Strengthen and Protect Worker Retirement Security

Defined benefit plans remain the best and soundest vehicles for building and safeguarding retirement income and security. Defined contribution plans, such as 401(k) plans are not substitutes for pensions, but to the extent they provide additional savings for retirement, our laws and regulations must include at least minimal safeguards to enhance protections for workers and stop corporate abuses.

In particular, the AFL–CIO supports wide-ranging reforms in 401(k) plans designed to address the public policy failings that led to the devastating impact of Enron's collapse on its employees' retirement security. The labor movement supports giving workers a right to sell company stock contributions to their defined contribution retirement plans and we support requiring 401(k) plans to provide independent investment advice to all participants from an advisor whose only interest is in providing good advice.

But just giving workers a right to sell the employer's stock is not enough. To be effective, any reform must address efforts by employers to encourage and induce workers to invest heavily in company stock.

Companies that do not try to protect their own workers' retirement security by giving them an adequate defined benefit pension should be given a choice with regard to company stock. If the employer does the right thing and provides its employees with a good enough defined benefit plan, in addition to a 401(k) plan, the employer should be allowed to make its contribution in company stock and offer com-

pany stock as an option for employees to invest their contribution. But if an employer insists on having a 401(k) plan as the only retirement security vehicle, then the employer should have to choose between making its matching contribution in company stock and offering company stock as an investment option under the plan, but it cannot do both.

While these measures could have made a difference for Enron employees, one of the lessons we should learn from Enron is that employer sponsors of 401(k) plans have myriad ways of managing the plan to suit the employer's interests rather than the plan beneficiaries' interests. And the current general fiduciary duties, limited as they are by section 404(c) of ERISA, are not an adequate constraint on this tendency. What we need are meaningful changes in 401(k) plan governance that empower employees as an effective counterweight to the conflicts of interest involved in exclusive employer control of these plans.

That is why the labor movement strongly supports the provisions of Rep. Miller's reform bill that would require equal participant representation on the boards of 401(k) and other defined contribution plans. This provision recognizes that workers have an enormous stake in how their retirement plans are run and that they should at least have a say in how the plans are managed. This should also apply to both public and private retirement plans, regardless of whether they are defined benefit or defined contribution plans.

Currently, most benefit funds that are sponsored by unions have half their trustees made up of beneficiaries. This arrangement not only gives workers a voice, but it also sets up a dynamic in the governance of the fund in which outside experts, because they are not solely beholden to the employer, are better able to give independent advice to the fund, advice to which the trustees are more likely to listen.

These changes could have made a real difference for Enron employees had they been in place last year. They also leave in place ERISA's current protections against conflicted investment advice. The House has passed a bill seeking to remove these protections, a bill which President Bush endorsed as a solution to the problems of Enron. As representatives of the labor movement have warned Congress in the past, letting the very money mangers who have an interest in selling high-fee products give advice is a measure that would expand the conflicts of interest already besetting worker funds. One would hope after Enron that we would all understand that the last thing we need to do is create more opportunities for companies, be they employers or investment managers, to exploit 401(k) participants.

Understandably, the short-run focus in Washington is on finding ways to protect workers against the kinds of abuses and intolerable risk workers bore at Enron, but Congress must go beyond fixing 401(k)'s. Workers need real pensions on top of Social Security. Yet, employers have been replacing valuable defined benefit plans with 401(k) savings plans at an alarming rate. This trend has been a long time in the making and will not be reversed easily, but it lays down an important challenge. It is critical that policymakers also find ways to provide greater incentives for defined benefit plans by changing national retirement policy, to level the playing field between defined benefit and defined contribution plans.

Conclusion

In conclusion, Enron was not an aberration, and it was not about one or two rogue executives. Enron was just what its executives and its boosters in the press said it was—one of America's leading companies—and it was leading us down the road to ruin. It took advantage of conflicts of interest that had been allowed to grow unchecked in our capital markets, and retirement policies that allowed employers to use workers' retirement savings as their corporate piggy bank.

The labor movement supports comprehensive, systematic reform of our capital markets and our pension laws now. In Congress today on both sides of the aisle there are those who understand that there must be change, and are ready to act. America's working families and their unions are behind that effort 100 percent. Obviously, as part of that commitment we stand ready to assist this Committee in its efforts to contribute to both understanding what happened at Enron and to seeing it doesn't happen again. Thank you for the opportunity to appear here today.

Chairman HOUGHTON. Thank you very much. Mr. Ebright?

STATEMENT OF DARY EBRIGHT, SPECIAL TESTER, WESTERN DIVISION, PORTLAND GENERAL ELECTRIC, PORTLAND, OREGON, AND MEMBER, INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS LOCAL 125, PORTLAND, OREGON

Mr. EBRIGHT. Good afternoon. I am Dary Ebright. I am 54 years old, and I am an Enron employee. I work as a Special Tester for Portland General Electric (PGE), Portland, Oregon, out of the Western Division. I am also a proud Member of International Brotherhood of Electrical Workers Local 125. I have been a Member there for 34 years, since 1967. In working with the union, I have also been on the negotiating Committee five times in that 34 years. I have been a shop steward and various union activities.

The reason I am here today is to tell you how the Enron collapse has affected me personally and to talk about the importance of retirement security in America. I want to tell you what my co-workers and I experienced at our company and why I believe the system is broken.

The type of company that we were before Enron came in and bought Portland General Electric in 1997 was a small utility, 3,000 employees. We were regional, involved in the community. Our stock stayed fairly close, between $23 and $28. It was a good investment for people to have. A lot of people had it. A lot of employees had it.

Then all of a sudden, in 1997, the company changed because Enron came in from Texas, a much different company. We did not know much about them, who was Enron when we first heard that they were trying to buy us. We found out that they were a much different company than we were. Yet, when they came in, all of our stock, they bought us. The PGE stock went away. We had to take, share for share, our Enron stock.

Where did we get that stock? We got that from our retirement savings plan that started in 1978, before 401(k)s. We started investing, and then when 401(k)s came along, we started investing and the company contributed company stock, Portland General Electric at that time, as part of their match to us. So over the years, some of us were able to accumulate quite a few shares.

Unfortunately, that good, solid, stable utility stock went away when this Texas company came in, and we did not know what was happening to us at the time.

Our plan also prevented us from selling any of the matching contributions of company stock until age 50. When I reached that age, Enron was in there. We were growing leaps and bounds because of the deceit that was coming from Enron. We did not know that the company was lying to everybody. The whole system failed in recognizing what was happening, and definitely the employees like myself could not recognize the fact that Enron was pulling the wool over our eyes, and so we invested heavily in it, some a lot worse than I did.

But, as an example, at one time, my 401(k) got as high as $968,000. It took a lot of years to get there. And of that, $495,000 was company stock. I was a little better than most. As time went on—I sold it last month, the Enron stock that used to be $495,000, for $2,300, and that is because the system is broke to allow the Se-

curities and Exchange Commission (SEC) not to see what happened, everybody did not see what happened.

I go on the Internet and I look at analysts that should be telling me, is this a good thing to invest in? My employer is telling me, Ken Lay, Jeff Skilling, all telling us to invest in the company. It is the way to go. The safeguards failed to let us know that these other analysts and auditors were not doing their job to warn us that it really was a sham that we were investing.

Consequently, a lot of us lost an awful lot of money in our retirement plans. An example, Roy Rinard, age 53 with PGE for 22 years, lost $472,000. Tim Ramsey, age 55, a special tester in Wilsonville, lost $1,000,020, all in Enron stock. He was going to retire last year in April but could not because of the amount that he had lost.

I was going to retire either this year or next year, and then all of a sudden after the collapse of Enron, I found out that now I am going to have to stay on a little bit longer. One of the fortunate things about staying on longer is that I know Social Security is going to be there to help. I was not able to take that and invest it in things that I should not have been investing a large part of my retirement security in.

Employees are not educated enough to know that we should not invest a whole lot in a company, even a Microsoft or an Enron, the large companies. This was the seventh-largest company in the United States that failed. How was I to know that it was not as solid as GE or one of the other big outfits? I did not know. I put more money into it than I should have.

I would like to see some changes in the future plans. I heard some people talking about lockdown periods. Today, with the computer age, I see no reason to have a lengthy lockdown period if they are going to change from one plan administrator to another, and unfortunately, in our system, some of us were locked out before they told us we would be. In the computer age, I think it could happen overnight or especially in a very few days.

Our management misled us. I think that they should be held liable. We should be able to believe management when they tell us that the company is doing good, the stock is going to $120. Instead, all we got was lies and the encouragement to not take the money out. When they locked us down, they kept us from taking our money out and that is really discouraging.

In conclusion, we hope Congress will make changes in the law so that if workers earn a company contribution to his or her retirement account and the company makes that contribution in company stock, a hardworking person should have the right to sell that stock when he or she chooses and not be forced to go down with the company. Something needs to be done about lockdown time periods, as I already mentioned.

Second, Congress should look into total control that the company had over the 401(k). Even though these were workers' retirement accounts, Enron held all of the cards. No one who was running the 401(k) seemed to have our interests at heart, and that is why we got nothing but lies from the management at Enron.

If company executives had not been allowed to mislead us and if we had been getting unbiased information about how best to pro-

tect our retirement money, fewer workers would have been hurt so badly because we would not have put so much into the company.

In closing, Congress should do what it takes to make sure that workers continue to get guaranteed benefits from Social Security and defined pension plans. Thank you for the opportunity to speak today.

[The prepared statement of Mr. Ebright follows:]

Statement of Dary Ebright, Special Tester, Western Division, Portland General Electric, Portland, Oregon, and Member, International Brotherhood of Electrical Workers Local 125, Portland, Oregon

I. INTRODUCTION

A. Personal Information

My name is Dary Ebright. I am 54 years old. I am an Enron worker; I work as a Special Tester for Portland General Electric's (PGE) Western Division, a wholly owned subsidiary of Enron. I am also a member of the International Brotherhood of Electrical Workers (IBEW) Local 125, where I have been a very active union member since I started with the company in 1967. Most importantly, I was elected by my peers to serve on the collective bargaining agreement negotiating committee five times in my 34 years with PGE.

The reason I am here today is to tell you how the Enron collapse has affected me personally and to talk about the importance of retirement security in America. I want to tell you what my co-workers and I experienced at our company and why I believe the system is broken.

B. Corporate Culture

First of all, you have to understand what type of company PGE was before Enron bought it in 1997. PGE has been in business for over 100 years. It was a very stable, local utility company that was run almost like a family business. PGE was very active in the community, and was a model of corporate and civic responsibility. Our stock price was steady, always within the $23 to $28 range. Putting your money into PGE stock seemed almost like putting it in a savings account at the credit union.

When Enron came in, it was riding on the unprecedented growth of the 90s, and turned PGE's culture upside down. Employees, and all Oregonians, were very skeptical of this fast-talking, Texas Corporation. When the sale was finally approved in 1997, our PGE stock was automatically converted to Enron stock, one-for-one. We did not have a choice. When the conversion to Enron took place, none of the employees realized how different this corporation was and what kind of impact it would have on our investments. We know now, that our stock went from being a stable, predictable asset to a volatile, high-risk gamble.

II. PLAN ASSET DIVERSIFICATION & RESTRICTIONS ON SALE OF COMPANY STOCK

A. How our Plan Worked

PGE was a trustworthy, solid company with which we had a good working relationship. There is a long history of collective bargaining that involves the PGE retirement/savings plan that dates back to 1978. This was the first year employees were allowed to contribute money from their paycheck to a company savings plan that was matched with PGE stock. This savings plan was designed to supplement our members' defined benefit pension plan and enhance their retirement accounts. At this time, these funds were not pre-tax or 401(k) type accounts—strictly savings accounts. In 1994, these savings accounts evolved into a 401(k) plan and became more sophisticated as the law allowed. We continued to bargain improvements, and as the 401(k) did better and better, our members got swept up in the "Enron frenzy" as we contributed more and more to our 401(k)s. Unfortunately, I have to admit, I was involved in the negotiating committees to direct our emphasis less on improving our defined benefit plan. In 1998, we even converted our defined benefit pension plan for our employees below the age of 42, to a defined contribution plan with Enron stock being a large part of the company contribution. What this amounts to is our employees below age 42 have lost the company contribution of Enron stock for their retirement for the last 3 years. Our plan also prevented us from selling any of the company's matching stock contributions until age 50, but even after that, I didn't think much about trading because the company convinced us that Enron was the best investment we could possibly make with our money. It was so good

that in 2001, I converted my defined benefit plan from a guaranteed annuity to a $200,000 lump-sum investment that would draw 5.25 percent interest until I retired. This looked real good, considering it was only one "leg" of my "three-legged stool" that PGE kept telling me that I had for a retirement plan (PGE pension, 401(k) and Social Security).

B. Personal Losses

At the height of Enron's stock success, My 401(k) plan was worth $968,000. $495,000 of that value was in Enron stock. I put 15 percent of my earnings into the 401(k) each pay period, and received a six percent matching contribution from the company in Enron stock. I was approaching retirement, and felt it was important to put as much as possible into my 401(k) because it was important for my future retirement security. I finally gave up in February of 2002, when the PGE employees received an e-mail that our stock was worthless, so we should sell it for what we could get out of it. I sold all of my interest in Enron for about $2,300. I worked hard to save for my future and now it is gone. I was going to retire in August 2002, now I am forced to work longer to try to make up for lost ground. I will probably be working until I am 62, when I get another "leg" of my retirement available, Social Security.

C. Stock Fluctuations

To summarize the wild ride we were on with stock prices from the height of the stock value in 2000 through the end of the lock down period:

- August 17, 2000—stock price $90; my 401(k) value, $960,000
- January 25, 2001—stock price $81.38; my 401(k) value, $835,000
- September 28, 2001—stock price $27.23; my 401(k) value, $403,000
- October 11, 2001—stock price $26.05; my 401(k) value, $357,000
- October 30, 2001—stock price $11.16; my 401(k) value, $321,000
- November 5, 2001—stock price $9.98; my 401(k) value, $320,000

D. Examples of Devastation

There are many stories that are just as devastating as mine. For example, Roy Rinard, age 53, has 22 years with PGE and had a $472,000 loss. He was hoping to retire early after many years of physically demanding work, but now cannot. Al Kaseweter, a special tester with PGE's Gresham Division, is 43 years old, has 21 years with PGE and has lost $318,000. Tim Ramsey, age 55, a special tester in Wilsonville, lost $1,000,020 in Enron Stock. He was going to retire last April but couldn't afford it after his losses. Dave Covington, age 42, has 22 years with PGE and lost $300,000. I could go on and on with stories of folks who have delayed retirement or were going to finance their children's education with these funds.

E. How Could This Have Happened?

You may wonder why I chose to put such a large percentage of my assets in Enron. Well, the answer is simple. I did the research, talked to a lot of people and invested my money in a "winner"—or so I thought. The stock was doing well, and all over the company, people said Enron was the best investment you could make. Words like "concrete" and "bullet-proof" were drifting through the halls of the shop as many folks watched the stock price climb in the late 90s.

As I mentioned earlier, in July of 1997, after the sale of PGE to Enron was complete, all PGE stock held by employees was converted to Enron stock automatically. We were all heavily invested in PGE stock up to that point, because it was extremely stable, and we had accumulated a lot of shares through the company savings plan before it was converted into a 401(k).

Instead of selling shares after the age of 50 I listened to Mr. Lay, Mr. Skilling and all the analysts, saying the stock would go back up to $120 per share. So, on February 26, 2001, I bought another 2,126 shares of Enron at $70.56, giving me 6,300 shares in Enron. At that point, my 401(k) went from 40 percent to 60 percent invested in Enron stock. I believed in the wrong people. At this time, I still had $723,000 in my 401(k), which was looking pretty good. Now, I am down to less than $300,000 when I was supposed to be retiring.

III. EFFECT OF LOCK DOWN

A. Date and Duration of Lock Down Disputed

As you know, the company made a switch in 401(k) plan administrators in, depending on whom you talk to, September or October 2001. This just happened to coincide with the company's announcement of a revised accounting statement detailing additional losses in revenue, followed by the most dramatic decrease in Enron stock value we had seen. In late September 2001, I, along with several other PGE

employees, attempted to access my account to sell Enron stock and could not. Our accounts seemed to be frozen before the official date Enron said the lock down period would start. I, as did many others, tried to contact our plan administrator for help. Usually, an employee would either be on hold indefinitely, or if they did get through, they were told the system was temporarily down and to try again later. I had decided to move some of my money from Enron, but when I couldn't get in, I told myself that selling Enron wasn't the right thing to do. My belief is—and I hope someone will investigate and verify my theory—that Enron froze out employees during this period to try to save the company.

The suffering people went through as they watched their futures crumble each day the lock down dragged on was unimaginable. The buildings were dead quiet. People were walking around in a daze. Everyone was in shock. Each person was trying to catch a glimpse of news on television to see if the situation had miraculously turned around, or had dramatically gotten worse. It was always worse. Emotions ranged from profound anger to unbearable grief and sadness. It was a brutal awakening.

IV. LACK OF ACCURATE INFORMATION FROM HIGH LEVEL EXECUTIVES

A. Misleading Information was Common

Many employees, including myself, followed the stock prices closely. When the value of our shares started to go down in April of 2001, and Ken Lay sold off millions of dollars in his own Enron stock, officials at the company would make excuses and ease our fears by talking about how the company was strong and the price would go back up. Our members were wondering why the CEO was selling so much stock if the company was doing well? We were told that, by law, Mr. Lay had to exercise a certain amount of these options periodically, and it was routine for CEOs to do so. Also in April 2001, Jeffery Skilling, then President and CEO of Enron, told employees that the stock was undervalued and would go up to $120 per share. This was also reported in *The Oregonian* (Oregon's statewide newspaper). On August 14, 2001, Ken Lay sent an email to employees stating, "Enron is one of the finest organizations in business today. Performance has never been stronger." On August 21, 2001, Ken Lay sent another email to employees expressing confidence that stock prices would continue to go up, which was also quoted in the Enron newsletter. So, as you see, the company officials kept encouraging us to hold onto our stock and never let on that our company was in serious trouble. We thought we were all working together, helping to build our company and make it strong. Never did we think that this collapse could happen.

V. ABSENCE OF SECURITY UNDER DEFINED CONTRIBUTION RETIREMENT PLANS

A. What is Left?

I feel lucky, compared to the thousands of Enron employees in Texas, who have no jobs and may be completely out of luck when it comes time to retire. I may have lost nearly $600,000, but at least I have a modest income waiting for me when I retire. I was planning on living relatively close to the standard of living I enjoy today, adding my Social Security benefits to my PGE pension and my 401(k) savings. Now, I have to put off retirement until I can make up at least some of what I lost. I can at least rest a little easier, however, knowing that my PGE pension gives me some real protection and is a foundation that I can add to as I start to rebuild my savings. It is important to have that guarantee—at least if PGE were to go out of business with the rest of Enron, the Federal Government would ensure my defined benefit pension so I wouldn't be left with absolutely nothing after all of my hard years of work for the company.

VI. CONCLUSION

A. What Can Be Done?

In our case with Enron/PGE, thousands of employees trusted their employer to tell them the truth and the employer deceived them. The fall out from this debacle will affect our country for generations to come. Our people played by the rules—they weren't all sophisticated investors, just hard-working, honest folks who became victims of Enron's lies. Thousands of people have been deprived of their futures. In our small part of the world, our best guess is that in excess of $800 million has been stolen by Enron, ruining nearly 3,100 lives and futures. We had members, guided by their faith in a company and its promises, who, in a matter of months, lost everything they spent decades saving for retirement.

We hope Congress will make changes in the law so that, if a worker earns a company contribution to his or her retirement account and the company makes that contribution in company stock, a hard working person has a right to sell that stock when he or she chooses and is not forced to go down with the company.

I also would like to see laws that deal with other things that went wrong at Enron. First, something needs to be done about lock downs. We were locked out of our accounts at a time when the price of Enron stock was falling sharply. Even though many company executives probably knew ahead of time that the stock was going to continue to fall, they went ahead with the lock down anyway. Congress should address the fact that company executives could do this, even though they, themselves, were still able to sell their own Enron stock.

Second, Congress should look into the total control that the company had over the 401(k). Even though these were the workers' retirement accounts, Enron held all of the cards. No one who was running the 401(k) seemed to have our interests at heart; at every turn, they seemed to be making decisions that were in the best interests of Enron, not the employees. Also, the information we got about our 401(k)s and Enron stock came from the company executives. We now know that we were being misled, but at the time, we trusted them. If workers' representatives had been in a management role in the plan, things might have turned out very differently. If company executives had not been allowed to mislead us, and if we had been getting unbiased information about how best to protect our retirement money, fewer workers would have been hurt so badly.

In closing, I want to say, again, how lucky I feel that I still have Social Security and my defined benefit pension. Together, they will give me real retirement security. Congress should do what it takes to make sure that workers continue to get guaranteed benefits from Social Security and defined benefit pensions.

Thank you for the opportunity to speak before your committee today.

Chairman HOUGHTON. Thank you very much. Ms. Perrotta?

STATEMENT OF DEBORAH G. PERROTTA, FORMER SENIOR ADMINISTRATIVE ASSISTANT, ENRON CORPORATION, HOUSTON, TEXAS

Ms. PERROTTA. Good afternoon, Mr. Chairman and distinguished Members of the Committee. Thank you for giving me the opportunity to come here today to share personal insights into the financial impact Enron's demise has on our family, former employees, pensioners, and shareholders.

My name is Deborah Perrotta, and I am a former Enron employee that was involuntarily laid off on December 5, 2001, along with nearly 6,000 others. I was employed by Enron from January 1998 to December 2001 as a Senior Administrative Assistant. During that time, I worked for Enron International, Enron Engineering and Construction Company, and Enron Energy Services.

My personal loss from the 401(k) was approximately $40,000. I started investing in the plan in June 1999 and in June of 2000, my account was over $21,000. By September of the same year, it grew to over $34,000. In December of 2000, I was awarded a bonus of $5,300, which I also elected to put in Enron's individual stock plan. I chose that stock award plan because I believed it was in my family's best interest to reinvest in the Enron stock based upon the continued confidence of Wall Street and management projections of the future growth and profitability.

Due to past adversities in our life, our retirement funds were not going to be sufficient, so when I came to Enron, we believed that we finally had a chance to rebuild our retirement funds. We had total faith in the board, Chief Executive Officer, and leadership team. Little did we know that they were inflating revenues and the stock price to increase their bonuses and that our board lacked the

integrity to ask the right questions and protect the shareholders, employees, and investors from fraud. By September of 2001, my 401(k) funds went from $39,000 to a little over $6,000.

In early 2001, Jeff Skilling was named chief executive officer. Soon after, he held an all-employee meeting in February where he touted that the stock was undervalued and by the year end would be valued at $120 a share. On August 14, 2001, after only 7 months, Mr. Skilling resigned. As a result, Mr. Lay reassumed the Chairman and chief executive officer position. Within days, he held an employee meeting and assured employees that Enron's value and reputation would be restored. He said, and I quote, that "the business model has never been stronger" and that it was only a question of transparencies that would renew investors' confidence. He was going to focus his attention on helping the analysts understand how we made money.

Mr. Lay followed up that meeting with an e-mail dated August 27, 2001, giving employee shares valued at $36.88 per share. In the memo he said, and I quote, "As I mentioned at the employee meeting, one of my highest priorities is to restore investor confidence in Enron. This should result in a significantly higher stock price. I hope this grant lets you know how valuable you are to Enron. I ask your continued help and support as we work together to achieve this goal." From this memo, many others and I were encouraged, since he was a seasoned, respected, and influential executive with great integrity and respect. In fact, he personally wrote the company's values. Today, I look back and feel so ashamed to have accepted his idea of respect and integrity.

A poll of 482 former employees/shareholders taken on January 28, 2002, showed a sum of $363 million was lost from their 401(k) accounts. Five of my friends' total losses combined exceeded $6 million. This may sound like we were rich people, but this was money that they were planning to live on in retirement. For my friends in their fifties, this money simply cannot be replaced.

Less than 2 weeks after the freeze ended, Enron filed for bankruptcy on Sunday, December 2, 2001. While many of us were suffering financially and emotionally, Enron wired $55 million in retention bonuses to a select few 2 days prior to filing. But I have seen nothing about the people who were paid these bonuses having to sign any contract committing them to stay at Enron. How is it that the bankruptcy court, board, and our leadership team could compound the situation by not protecting either the money or intellectual capital through some form of penalty for leaving?

And, of course, those of us who were laid off had our severance checks frozen because we were laid off a day after bankruptcy filing. We are now fighting in court to get the severance thousands of us desperately need while some of the very people who got the bonus are paying Wall Street lawyers to stop us from getting the money they promised us. Many thousands of us need to pay rent, health insurance, and other necessities.

It seems to me that at every turn, the way the law works and decisions Enron executives made combine to see that a handful of people got millions and thousands of people who worked to build Enron lost everything. I and thousands of others lost the resources we had counted on to fund our retirement and feed our families.

I am not alone in my pain. I am just one of thousands of former employees and retirees desperately looking for relief and eventual reform. I do not enjoy coming here, but herein lies many lessons to the American worker and it is imperative that you take the appropriate steps to correct the reforms necessary to protect the American family.

To do so, I recommend the following. Companies should provide their employees with both a defined benefit pension plan and a 401(k), then if employees choose, they can put their 401(k) money in company stock; employees or independent oversight have active participation in overall plan management; provide employees with key information they need to make wise decisions; representation of both employees and employers in overseeing administration of plans, the ERISA; employees to have the right to sell company stock in their defined retirement accounts in favor of diversified investment options; management should not have the right to sell stocks during a blackout; if employees put their retirement money in the company stock, the company needs to back up the stock with some kind of insurance for catastrophic loss so that those employees are not at risk of losing everything. Senator Hutchison has told me she supported this concept.

It seems that there are too many loopholes for corporations to use the retirement laws to their advantage and not of their employees. It scares me, knowing that I only have a few years to try to increase my retirement funds. I do have a small retirement from my previous job, but by no means that will sustain my everyday living expenses. Right now, it appears that I would have to heavily depend on my Social Security benefits, which is guaranteed by the Federal Government.

It frightens me to know there are efforts to privatize Social Security. I confess I have not given it much thought, but given what I have and many others have been through in the past few months, I am here to tell you if there is not a reform for the 401(k) plans, the privatization of Social Security would be a big huge mistake. Just like Enron, there is no telling what could happen to Social Security benefits if they were dependent on the ups and downs of the market.

The demise of Enron should clearly send up a red flag that there must be reform to the 401(k) plans and to keep Social Security where it is now. Do not let the American workers' faith in you be misguided, as well. You are a last line of defense. Thank you.

[The prepared statement of Ms. Perrotta follows:]

Statement of Deborah G. Perrotta, Former Senior Administrative Assistant, Enron Corporation, Houston, Texas

Good afternoon, Mr. Chairman, and distinguished members of the Committee. Thank you for giving me the opportunity to come here today to share personal insights into the financial impact Enron's demise has had on my family, former employees, pensioners and shareholders.

My name is Deborah Perrotta, and I am a former Enron employee that was involuntarily laid off on December 5, 2001 along with nearly 6 thousand others. I was employed by Enron from January 1998 to December 2001 as a Sr. Administrative Assistant. During that time, I worked for Enron International, Enron Engineering and Construction Company and Enron Energy Services.

Due to the accounting practices, lack of ethics and weak legislation coupled with Enron's freezing of our 401k plans, I and thousands of others lost our jobs and the resources we had to fund our retirements. Because I was contemplating retiring at

the age of 58, I increased my deductions because I believed Enron was secure, since Arthur Anderson, analysts, management and the investment community routinely validated it.

My personal loss from Enron's 401k was approximately U.S. $40,000. I started investing in the plan in June of 1999. In June of 2000 my account was over $21,000, by September of the same year it grew to over $34,000. In December of 2000, I was awarded a bonus of U.S. $5,300, which I also elected to put in Enron's individual stock plan. I chose the stock award plan because I believed it was in my family's best interests to reinvest in Enron stock based upon the continued confidence of Wall Street and management's projections of future growth and profitability.

Due to past adversity in our life our retirement funds were not going to be sufficient, so when I came to Enron we believed that we finally had a chance to rebuild our retirement funds. We had total faith in the board, CEO, and leadership team. Little did we know that they were inflating revenues and the stock price to increase their bonuses and that our board lacked the integrity to ask the right questions and protect the shareholders, employees and investors from fraud. By September of 2001, my 401k funds went from $39,000 to a little over $6,000.

Let me take a moment to paint a picture of why everyone was excited about Enron and it's stock.

It was a dynamic and exciting place to work. They had an unbelievable reputation and were known for innovation and hiring the best of the best. Every one gave 110 percent to the company that is why we were able to grow so quickly. Or so we thought!

There was an atmosphere of great pride, trust, and respect for the management and Enron's invincibility. I was ecstatic to be associated with a winner, whose mission as defined by Mr. Skilling was to be "The World's Leading Company." If you doubted it, you only had to attend an employee meeting and read our literature to have any of your doubts removed. We felt great optimism, security, and confidence about the company's future.

In early 2001, Jeff Skilling was named CEO. Soon after, he held an all employee meeting in February, where he touted that the stock was undervalued and by year-end would be valued at $120.00 a share. On August 14, 2001, after only 7 months, Mr. Skilling resigned. As a result, Mr. Lay reassumed the Chairman and CEO position. Within days, he held an employee meeting and assured employees that Enron's value and reputation would be restored. He said, and I quote, that "the business model has never been stronger" and that it was only a question of transparencies that would renew investor confidence. He was going to focus his attention on helping the analysts understand how we made money.

Mr. Lay followed up that meeting with an e-mail dated 08/27/01, giving employees shares valued at $36.88 per share. In the memo he said, and I quote, "as I mentioned at the employee meeting, one of my highest priorities is to restore investor confidence in Enron. This should result in a significantly higher stock price. I hope this grant lets you know how valued you are to Enron. I ask your continued help and support as we work together to achieve this goal." From this memo, many others and I were encouraged, since he was a seasoned, respected, and influential executive with great integrity and respect. In fact, he personally wrote the company's values. Today, I look back and feel so ashamed to have accepted his idea of respect and integrity!

In September we were notified that the company was changing saving plan administrators, and the last date for any investment fund balance changes would be October 26, 2001. The notice stated that certain kinds of fund transactions would not be possible after October 19, 2001. Finally, the notice said that the transition period would end on November 20th. I have heard that in Oregon 401-k participants may have been locked out earlier.

Two or three days prior to the change in plan administrators Enron took a $1.2 billion write down. In retrospect they knew about the issues and concerns of Sharon Watkins and yet they still locked the employees in without any chance to salvage what was left. They could have canceled this process but they chained us to the sinking ship while they were able to exercise their options during the three-week blackout period.

During this period of the lockout Enron's stock price fell by more than 50%—from $15.40 at the close on October 26 to $7.00 at the close on November 20. However, while we had to wait during the blackout period, our leadership had the ability to move their stock. This is terrible, what is good for the goose should be good for the gander. However at Enron the gander got rich and we had our goose cooked.

To compound the situation on November 14, an e-mail was circulated stating that a new plan website was up. However the email did not say that we could now make

investment fund balance changes. This in fact may have caused people to lose additional value in their 401K.

A poll of 482 former employees/shareholders taken on January 28, 2002 showed a sum of $363 million dollars was lost from their 401k accounts. Five of my friends' total losses combined exceeded $6 million. This may sound like these were rich people, but this was money that they were planning to live off in retirement. For my friends in their fifties, this money simply cannot be replaced.

Less than two weeks after the freeze ended, Enron filed for bankruptcy on Sunday, December 2, 2001. While many of us were suffering financially and emotionally, Enron wired $55 million in retention bonuses to a select few two days prior to the filing. But I have seen nothing about the people who were paid these bonuses having to sign any contract committing them to stay at Enron. How is it that the bankruptcy court, board, and our leadership team could compound the situation by not protecting either the money or the intellectual capital through some form of penalty for leaving? And of course those of us who were laid off had our severance checks frozen because we were laid off a day after the bankruptcy filing. We are now fighting in court to get the severance thousands of us desperately need, while some of the very people who got the bonuses are paying Wall Street lawyers to stop us from getting the money they promised us—money thousands of us need to pay rent, health insurance and other necessities.

It seems to me that at every turn the way the law works and the decisions Enron executives made combined to see that a handful of people got millions and thousands of people who worked to build Enron lost everything.

I and thousands of others lost the resources we had counted on to fund our retirements and feed our families. I'm not alone in my pain, I'm just one of the thousands of former employees and retirees, desperately looking for relief and eventual reform**.** I don't enjoy coming here, but herein lies many lessons for the American worker, and it is imperative that you take the appropriate steps to correct the reforms necessary to protect the American family.

To do so, I recommend the following

- Companies should provide their employees both a defined benefit pension plan and a 401-k. Then if employees choose they can put their 401-k money in company stock.
- Employees or independent oversight have active participation in overall plan management;
- Providing employees with key information they need to make wise decisions;
- Representation of both employees and employers in overseeing administration of plans (ERISA).
- Employees to have the right to sell company stock in their defined retirement accounts in favor of diversified investment options;
- Management should not have the right to sell stocks during a black out;
- If employees put their retirement money in the company's stock, the company needs to back up that stock with some kind of insurance for catastrophic loss so that those employees aren't at risk of losing everything. Senator Kay Bailey Hutchison of Texas has told me she supported this concept.

It seems that there are too many loopholes for corporations to use the retirement laws to their advantage and not that of their employees. It scares me knowing that I only have a few years to try to increase my retirement funds. I do have a small retirement from my previous job, but by no means that would sustain my everyday living expenses. Right now it appears that I would have to heavily depend on my Social Security Benefits—which is guaranteed by the Federal Government.

It frightens me to know that there are efforts to privatize Social Security. I confess I haven't given it much thought. But given what I and many others been through in the last few months, I am here to tell you that if there is not reform for the 401K plans, the privatization of Social Security would be a big **HUGE** mistake. Just like Enron, there is no telling what could happen to Social Security benefits if they were dependent on the ups and downs of the market.

The demise of Enron should clearly **"send up a red flag"** that there must be reform to the 401K plans and to keep the Social Security where it is now.

Don't let the American workers faith in you be misguided as well. You are our last line of defense.

Thank you.

Chairman HOUGHTON. Thank you, Ms. Perrotta. Mr. Ursprung?

STATEMENT OF CECIL URSPRUNG, CHIEF EXECUTIVE OFFICER, REFLEXITE CORPORATION, AVON, CONNECTICUT

Mr. URSPRUNG. Thank you, Chairman Houghton and Members of the Committee. My name is Cecil Ursprung. I am an employee and an owner of Reflexite Corporation in Avon, Connecticut. I also serve the company as Chief Executive Officer.

Reflexite is an employee-owned company with facilities in central Connecticut and upstate New York. We also own facilities in several places outside the United States. Our Representative in Congress is Nancy Johnson, who was formerly Chair of this Oversight Subcommittee, and I am honored to be here.

There are almost 400 employee owners at Reflexite. We are a technology-based manufacturer of optical films and components. We generate about $65 million in annual sales and our largest shareholder is the employee stock ownership plan, which owns 38 percent of our company.

The employees have purchased outside the ESOP another 25 percent of the company. This is an important fact, because it means that the employees clearly determine the future and are in control of our company.

Since 1985, our ESOP has grown from $150,000 to a value in excess of $30 million. We created quite a bit of value for the owners of our company.

The history of our company is a typical American entrepreneurial story. The founders in 1970 were two Yale-educated Connecticut brothers who had a history of innovation in plastics going back to 1987. In the early eighties, the Rowland brothers faced the same decision that is faced by every other entrepreneur that ever existed in America, and that is we are all mortal and what to do with the company. They had three choices. First, they could pass the company on to family Members. Second, they could take the company public. And third, they could sell the company and retire.

In the case of the Rowlands, there were no family Members to pass the company on to. Our sales were only $3 million during that time, and it was not feasible to go public. And the Rowlands were simply not ready to sell and retire. So we formed an ESOP, which is the fourth alternative for businessowners, created by Congress in 1976, a very enlightened piece of legislation, in my opinion.

Since the formation of our ESOP in 1985, we have made three significant adjustments that I think will be of interest to the Oversight Subcommittee. First, we create an international ESOP so that all employee owners, including those, almost 200, outside the United States could become shareholders in our company. You can imagine the challenge that we faced as employee owners trying to introduce employee ownership in our factories in the former East Germany and in the People's Republic of China. This has been an interesting experience. We are certainly doing our part to spread the economic system of America around the world.

Second, we instituted a 401(k) plan in 1989. We like the plan, and it allows for our people to save for their own retirement and encourages companies to match.

Third, we found that the 55 and 10 regulation passed by Congress was not suitable for our company and so we changed that pol-

icy in our plan and now anyone who is fully vested can begin a diversification program out of the ESOP and into their 401(k).

In my written testimony, I have provided a number of details on these evolutionary steps and the testimony of eight of our owners who have been with the company for some period of time and their experience with our 401(k) and our ESOP.

Now let me just turn my attention to Enron for just a moment. In my opinion, the Enron disaster is a result of three factors: First, an explosion of greed on the part of people both inside and outside the company; second, a total breakdown in the usual internal controls that exist in an American company; and third, out and out fraud created by certain individuals. Ladies and gentlemen, I do not believe that an exceptional incident like this forms the foundation for good legislation.

I do have four recommendations in my written testimony, and I would like to focus down to two questions that I believe you should ask as you consider legislation. First, does the provision that you are considering enable a more informed decision on the part of employees? And second, does the provision more closely align the financial interests of top executives and employees in the country? If you can answer those two questions, I think you are doing well by our system.

In conclusion, I have traveled around the world expanding Reflexite, and I have come to believe that America's economic preeminence in the world is not an accident. And as I travel around the world and observe different systems in action, I think that we can attribute our success in the global economy to two principal things, one of which is very important to this Committee.

The first is we educate our young people better than any other country that I have visited, and I have visited over three dozen of them in the last 15 years.

And the second, there is an enormous spirit of entrepreneurship and ownership in this country that does not exist anywhere else in the world, and it is precious and it is a national treasure and we all ought to, those of us who manage companies and those of us who legislate, ought to do what we can to nurture that entrepreneurship and that ownership. It helps us be competitive in an increasingly global competitive economy.

Finally, I want to thank you for the encouragement that you have given to stock ownership in this country since 1976 and I am confident that you will continue your good work in the 107th Congress. Thank you.

[The prepared statement of Mr. Ursprung follows:]

Statement of Cecil Ursprung, Chief Executive Officer, Reflexite Corporation, Avon, Connecticut

Mr. Chairman, Members of the Committee, my name is Cecil Ursprung. I am CEO of Reflexite Corporation in Avon CT. I have been employed by the Company for 18 years.

Reflexite is an employee-owned company with its most important facilities located in Central Connecticut and Rochester, New York. In Connecticut, our Congressional Representative is Congresswoman Nancy Johnson who serves both our New Britain and Avon locations. We have a long-standing positive relationship with Congresswoman Johnson and we are aware of the fact that she is a past Chair of the Oversight Committee. Aside from our locations in the United States, we also have manufacturing facilities in Ireland, Germany and Peoples Republic of China. In addition,

we have sales offices in both Europe and Asia. Reflexite employs approximately 390 people and we are a manufacturer and marketer of optical films and components. Much of our films business is devoted to Reflective Products which are used in work zones, personal safety applications and marine applications to enhance visibility and safety. Our optical components are used mostly in displays such as personal computers and LDC projectors. We generate approx $65,000,000 in sales and our largest shareholder is our Employee Stock Ownership Plan which owns 38% of the company. In addition, employees own another 25% of the company outside the ESOP so that the destiny of our company is clearly in the hands of people who are employee-owners. The history of our company is a story of typical American entrepreneurship. Two Connecticut brothers, Yale educated engineers, founded Reflexite in 1970. It was #19 in a series of companies founded by Hugh and Bill Rowland beginning in 1947. All these companies were based on innovations in plastics.

I became President of the company when I joined in 1983 as the successor manager for the Rowland brothers. At that time, they were in their 60's and it became evident that there was going to be a transition in ownership as well as management. As is typical of other entrepreneurs, the Rowlands had three choices regarding the future ownership of Reflexite Corporation.

- They could pass the company onto other family members
- They could take the company public
- They could sell out and retire.

In the case of the Rowland's, there were no family members interested and eligible to take on the responsibilities. At $3,000,000 in sales Reflexite was too small to become a public company and the Rowlands were not ready for retirement. Even in their mid 60's they were both actively engaged in the business. Fortunately for us, in 1976 Congress created a fourth alternative for the Rowlands called an Employee Stock Ownership Plan. After a thorough investigation of ESOPs, we terminated a defined benefit pension plan, paid all of the benefits owed to the participants, and established an ESOP with the $150,000 left as excess assets. Through additional allocations and the appreciation in the valuation of our company that $150,000 has grown to over $30,000,000 owned by the ESOP participants. For those interested in such things that's a compound annual growth rate over the 16-year period in excess of 20% per year. At Reflexite we are very active in promoting ownership as part of our culture rather than just pension plan. I believe that world class technology combined with employee ownership are the two reasons our company has been successful over such a long period of time. Our pathway has not always been straight up. During the last 16 years, we have had two periods of business decline and we are in the second one at the current time. I believe that being employee owned has served us better during periods of decline than in even expansionary times.

I present myself to you as a hardheaded businessman with an MBA and an eye on the bottom line. I am an enthusiastic supporter and participant in employee ownership not out of altruism but because I believe it is a superior way to manage a company. Just as Henry Ford's approach was right for his time with task simplification, division of labor on the assembly line, etc. employee ownership is right for our post industrial economy where employees are often as educated as their managers.

During my tenure at Reflexite, I have traveled outside the U.S. extensively as we have sought to build a global presence for our company. On the basis of my travel in about 30 countries, I would like to suggest to you that there are two overriding reasons for America's economic superiority in today's global economy. First, we educate our young people better than other counties. Second there is a spirit of entrepreneurship and ownership in this country that is unmatched elsewhere in the world. American entrepreneurship is legendary and Americans own more stock in their companies and more stock in other companies than citizens anywhere else in the world. This is a significant factor in our economic success. **Ownership is a national treasure which must be not only protected but nurtured**. Perhaps this is why I feel that the ESOP legislation passed by this Congress is some of the most enlightened legislation ever passed. In their full potential ESOPs are a win for employees, a win for shareholders who are transferring stock to employees and a win for the companies. This win-win-win translates to a fourth win and that is a win for the United States of America in a global economy.

During the evolution of our ESOP we have made three significant adjustments which I think will be of interest to you.

- First, several years ago we created an international ESOP so that all our employee-owners outside the United States could become shareholders in the

company. You can imagine the challenges we faced trying to introduce stock ownership in the former Eastern Germany and in the Peoples Republic of China. But ownership has been such a positive influence on the success of our company that we want to install it worldwide and we will work until we get that job done. Every three years we survey 100% of our employees around the world and ask their opinion about Reflexite as a place to work. Nine years ago in our first survey we found that the ESOP was affecting the behavior of about 50% of our people. In the last survey 80% of Reflexite employee-owners said being an owner had a significant impact on their behavior. And, I can tell you that that attitude has a positive impact on our competitive position in the global marketplace. In fact, research has shown that ESOP companies are more successful over time than non-ESOP companies in the same industry.

- The second important element in the evolution of our ESOP was the institution of a 401(k) Plan in 1989. This we feel is another enlightened piece of legislation by Congress which allows people to save for their own retirement and encourages companies to provide a match. Reflexite does provide a cash match for people who participate and our participation has recently been almost 100%. At Reflexite we don't do things half way. The 401(k) Plan has provided the employee-owners a valuable tool for diversification and for enhancing their savings and retirement strategy.
- The third element in the evolution of our ESOP occurred two years ago when we liberalized the rules for diversification. As you can imagine with a growth rate exceeding 20% per year many of our employees ESOP account is their largest asset, larger than the equity in their home for example. The federal regulations call for mandatory diversification options at age 55 and ten years of service. Reflexite has reduced this factor by stating that anyone in our company who is fully vested in the ESOP may begin a diversification program into their 401(k). Each year the company provides funds and people apply for diversification. The funds are distributed in an equitable manner and used to cash out shares and transfer the cash to the ESOP where people can make diversification decisions. Reflexite stock is not an option for investment in our 401(k).

In my written testimony I have included a number of comments from employee-owners in Reflexite regarding their attitudes and feelings on our ESOP and employee ownership in general. Having given you this background, let me now turn my attention to a few comments on the Enron situation and what I believe Congress should be doing to protect the interests of employees and the national interest in entrepreneurship and ownership. In my opinion, the Enron disaster was caused by a combination of three factors**:**

First, an explosion of greed in people both inside the company and outside. This includes employees, auditors, investors and stock analysts.

Second, I believe there was a total breakdown in the usual internal controls that exist within in a company and its Board and between a company and its auditors. This breakdown was caused at least in part in my opinion by severe conflicts of interest that existed at several places in both Enron and Arthur Andersen.

Third, I believe that Congress will find that the Enron situation was acerbated by fraudulent activities by a number of people and I would not be surprised to find that other criminal activity other than fraud has occurred. I make these three points first because I believe they are true and secondly because I believe it would be a mistake to target legislation based solely on what happened at Enron. As far as I am concerned Enron is an unusual occurrence in our economic system. And, if we are going to legislate and regulate further regarding retirement plans we need to take a better perspective than just an explosion of greed, a breakdown in internal controls and fraud. My opinion is helping insure our prosperity in a global economy. Ladies and Gentlemen this is not a partisan issue. This is a national issue which affects the economic strength of our entire country. Perhaps it would be well for you to take a sentence from the Hippocratic oath, "First do no harm".

Once reason prevails again, I would suggest four areas that Congress concentrate on for a fruitful venture into legislation and regulation:

- First, I believe that improvements can be made in the area of employee information access and employee education. We have done training in our company of a very basic nature on what is stock, what is ownership, what is capitalism. There is a lot that public and private educators could do to enhance the knowledge of our citizens in this area. Activity here would not only produce more knowledgeable investors but an increased understanding and commitment to the American economic system.

- Second, I think we could make some improvements in aligning the interests of executives and employees in companies. A good example often mentioned is lockdown periods during times of transition and 401(k) Plans. I believe we could go further in insuring that executives cannot act in their own interests at the expense of the employees that they lead.
- Third, I believe there is justification for additional SEC oversight regarding public companies. It is essential in our economic system that investors have timely, accurate, reliable information from publicly owned companies. We have all seen the impact of secrecy in this area in other countries and such conditions should not be tolerated in the United States.
- Fourth, I believe that the current conflict of interests that exists among audits/consulting firms in the United States should be eliminated. Voluntary efforts by the accounting profession are underway and Congress can play a role in seeing that these efforts become uniform and permanent. I believe Reflexite is a fine example of American entrepreneurship that began with two brothers and expanded to almost 400 citizens. I hope that you will legislate in a manner that encourages this kind of activity in our country.

Mr. Chairman and Members of the Committee, I thank you for the opportunity to speak with you today and thank you for the encouragement you have given to stock ownership in this country since 1976. I am confident you will continue your good works.

REFLEXITE CORPORATION

EMPLOYEE–OWNER TESTIMONY

I am David Correa and I am a Materials Manager at Reflexite Corporation.

The meaning of employee ownership has changed for me over the past 12 plus years of employment with Reflexite. At first it only meant that I would be eligible for a monthly owners' bonus check and a yearly owners' vacation day after completing one year of employment. I did also understand that shares of stock would be set aside as part of my retirement or pension plan, but it took a while longer for me to really develop my feeling of employee ownership.

My pride, passion, enthusiasm, interest, and concern about what I could do from my position in the company to help it continue to grow began to multiply. I began to look for ways that I could help outside of my area. Employee ownership keeps me looking for ways to help my fellow employee owners find improvements wherever possible.

Few things can give me the same personal satisfaction that comes with knowing that my actions have a direct effect on the company for which I have partial ownership. It is being rewarded for your dedication and commitment beyond a paycheck. I can compare it to the gratification that you get when you go from paying rent to buying your first home.

My name is David Korncavage I have been at employed at Reflexite for 12 years. My position is Team Leader of our Logistics Department. Before working for Reflexite, I had several jobs from working at union shops to working for myself in the construction industry.

The first experience I had at Reflexite as an employee-owner was two months after I started, I was issued my first stock allocation. I was so happy to have 11 shares of stock. It made me feel like I owned a piece of the pie. I started to wonder what things I could do to raise the stock value. I was given the opportunity to act like an owner instead of coming to work and just punching the time clock and leaving my brain at the door. I was challenged to use my skills and to feel and act like an owner. Little did I know what an impact on my life this would have.

I started to working in the Shipping Department and had the opportunity to negotiate shipping rates and purchasing production supplies with the confidence that all my work would affect the company's stock value. I was given the chance to be a member of our ESOP Education Committee. This was a turning point with my understanding of how ESOPs work. I was able to attend the National ESOP Convention and speak about my experience of ESOPs and Reflexite. I was so proud to be representing my company at a national level. Now it is twelve years later and I was able to send my daughter to college and buy a house. My total experience at

Reflexite has given me the means to guide my own destiny and have a full feeling of what it is to be a true owner of a company.

I, Dorothy Waszczuk, a Manufacturing Team Leader II, have been employed by Reflxite for 12 years.

Working for an ESOP company has been and still is a great learning experience for me. I am so much more informed about things that are happening within the company. As an ESOP employee I am privileged to have access to more business information. I am more motivated to work harder because I have the feeling I am working for myself.

As an ESOP employee I have a certain say in the way things are manufactured. Because there is an open door policy, I feel free to express my suggestions. I am motivated to work harder because if the company does well, I will also benefit in the future.

Because everyone is an owner there is a great deal of respect for co-workers. I would find it difficult to work in another company where I could not express my concerns and offer ideas to improve company performance.

I, Kevin Hudson, a Material Flow Supervisor, have been employed at Reflexite for more than 12 years.

Working for an employee-owned company gives you a sense of ownership. Knowing that once you have completed a project, and everyone has done his or her job, there is a tremendous sense of accomplishment.

We all have one common goal, which is to improve the stock price. To help us affect the stock price, we are provided with training in finance, which includes understanding costs, revenues and operating profit. There is openness with the financial information and employee-owners are encouraged to question business decisions. People feel comfortable suggesting ideas for improvement.

You get recognition for a job well done. Employee-owners often celebrate when we exceed our financial targets or when we beat the competition—and we know our competition.

All employee-owners are given opportunities to grow and opportunities to shine. I felt a great deal of pride when the company asked me to represent Reflexite by speaking on ownership at the Annual ESOP Conference in Washington, D.C.

Because I have such a strong sense of ownership, I have often gone above and beyond the call of duty. It is not unusual to see employee-owners working extra hours or going the extra mile to get the job done.

I, Cynthia Mahlstedt, a Public Relations Specialist, have been an employee-owner with Reflixte for nearly four years. The corporate culture at an ESOP company is like no other. Other companies pontificate about open-door policies, levels of trust, respecting the general work force, encouraging idea-sharing, continuous improvement, internal communication, mutual respect, teamwork, empowerment, and all of the other "buzzwords" that would make Jack Welch proud.

This is the **only** company I've ever encountered that walks their talk and talks their walk. You can't wake up one morning and expect your workforce to be dedicated, and willing to go the extra mile for the sake of the company. It's not a mission statement on the wall, it's not a training session, team-building session or a suggestion box that makes it work. It's a long-term dedication to the principles and it's employee-ownership that makes the difference; employees need to have a real stake and a genuine say in the day-to-day operations of the company.

As an employee-owner, I am motivated to excel and motivated to achieve results, because I understand how my contribution affects the company's bottom line, and my own financial success is a direct result of my successes here at work. I don't have to be an accountant, or even a college graduate, because my fellow employee-owners and members of senior management understand how important it is that I understand where we are where we're going and what we need to do to get there.

There is a level of understanding—knowing how and why decisions are made. Sharing information and empowering employees to affect the company's success seems to avoid the all too common "rumor mill" that leads to dysfunctional employee-employer relationships and mistrust that is prevalent at so many other corporations.

Working in advertising agencies for several years prior to joining Reflexite, I've been exposed to and have worked with dozens of companies including some well-

known Fortune 500 companies. Not one of them enjoys the level of dedication and open communication that is vital to our company's success.

Sharing financial information, explaining strategic business decisions and committing to regular face-time between senior level management and every other employee-owner builds a level of trust, dedication and a commitment to excellence.

My name is John Gagas. I have been employed by Reflexite Corporation for over 11 years and I currently occupy the position of Operations Controller for the Reflexite Films Division. I have been asked to express my feelings on ESOP's and employee-ownership.

I worked for two Fortune 500 companies prior to joining Reflexite Corporation. My experience working for these highly regarded and profitable companies was good but something was missing for me. The part that was missing was real ownership and the ability to have input in helping to create wealth for a company and, in the end, myself. This is the major reason that attracted me to Reflexite Corporation. This motivation was not only the ability to share in the rewards through an equity stake, but also to have a small role in helping to make "the pie" larger. This is the type of entrepreneurial culture that employee-owned companies build.

Reflexite Corporation is not a company for individuals who do accept risks. We live with the risk of the Employee Stock Ownership Plan significantly decreasing if the appraised value of the shares drops in value. This risk is one that is well communicated to every potential new employee-owner prior to being hired. Also, understanding that this potential risk exists is very important. Over my last eleven years, Reflexite has not only recognized this risk but has put many programs in place to mitigate it. Reflexite has created a 401(k) matching program that gives every employee-owner a 25% contribution match on the first $1,000 contributed by the employee. This was done to create an incentive for every employee-owner to participate in the 401(k) plan, which does not have stock of Reflexite Corporation as an investment option. Also, Reflexite Corporation has started the Safe Harbor contribution, whereby Reflexite Corporation contributes 3% of every employee-owner's gross wages to the employee-owner's 401(k) account. This contribution becomes immediately vested to the employee-owner. The 3% Safe Harbor contribution is subtracted from the annual ESOP distribution for every employee-owner. Another method of promoting diversification is the Annual ESOP Diversification program that allows employee-owners to move funds from their ESOP account to their 401(k) account.

Empowered employee-owners understand the potential risks of working for an ESOP company. We accept these risks because we choose to work for a company that has a common focus to grow the long-term value of the company for the benefit of all employee-owners. This entrepreneurial spirit is at the heart of true employee-ownership.

My name is Sandy Black, I have been employed at Reflexite for almost 24 years. I am the Manufacturing Scheduler and Customer Service Representative.

During my years of service, I have witnessed a lot of changes. One in particular was when Cecil Ursprung and Hugh Rowland introduced the ESOP to the company. Mostly everyone panicked, Cecil was fairly new and we all had trusted in Hugh. We listened carefully. There was a lot of apprehension, so the company agreed to keep a floor plan as a safety net until we were all confident in the ESOP.

Well my retirement fund took off! The floor plan was dropped and monies from the account were placed into 401K account for all employees.

Before we were an ESOP company; it was a job!

As we became an ESOP company education about ESOP was very crucial. An ESOP committee was formed and a bulletin board was in place. If anyone had questions, they were written and submitted to the ESOP committee. The question and answer were posted on the board for all employees to read.

Once we were an ESOP, employees began looking at the company as a true owner would. We were all empowered and encouraged to ask questions and make suggestions. We all became more quality critical. We began looking into ways to cut back on spending. We looked for ways to improve processes within our work areas to have things flow smoothly and Management listened. Changes were made. Things began to run smoother and easier. Everyone felt a sense of pride in what we did.

And we got better at what we were doing.

When we hit harder times we became creative on saving money for US. We strive to preserve our stock price.

The way the ESOP was originally structured, we couldn't touch our money unless we were age 55 and 10 years of service. Being that I joined the company when I was 18. I wouldn't have had access to my account for 37 years. We expressed these types of concerns at some meetings and it was changed. Now, yearly we can take a portion of our ESOP account and place it in our 401K accounts. We can take loans against our money or move them into the different funds. I feel better knowing that all my eggs are not in the same basket and that if I needed the money to pay for my daughters' college, I have access to some of the funds. I feel much better knowing I have some type of control over the funds.

I also feel that if the ESOP were not introduced to us, my retirement fund today would be much lower. I feel comfortable knowing when I retire I should be able to have a comfortable life.

Mark Lavoie
Senior Product Development Engineer
Employee / Owner of Reflexite Corporation for 4.3 years

While I have only been a Reflexite employee / owner for just over four years, I have a total of 15 years of experience from three additional companies, which all had very similar manufacturing capabilities. These previous companies were both larger and smaller than Reflexite and were both Union and none union shops. With a degree in chemistry and strong mechanical engineering capabilities, I have held a variety of positions through out my career.

With this experience, I had a good understanding of what the converting industry was all about. So, when it became time to think about a career move I had a good idea of what I could expect and what to look for. During my search for my next career move I interviewed with several companies and had a couple offers on the table. The opportunity at Reflexite became available to me late in the game, but when I heard some of the unique aspects of this company I said hold everything. I had very candid discussions with Reflexite and informed them of my position, but I was also very interested in Reflexite. Reflexite was also very interested in me and mobilized very quickly (within a day I think) to accommodate my situation and get me in and through their extensive interviewing process. This was significant to me for several reasons: I saw that the company could organize and move quickly to accommodate an individual. (I met with approximately ten people ranging from peers to senior managers through presidents and the CEO.) The interviewing process alone was very impressive and I was told that a new hire is a big deal to everyone because everyone has a vested interest in getting the best. I learned a lot about Reflexite during the interview process and saw a company of the likes I had never seen before.

While the salary range was acceptable and the long term stock plan for retirement and the owners bonus plans sounded very attractive, there was still something more. This company put a high value on Engineers and technology and seemed that it would do what needed to be done to be successful. This was what I was looking for. Still there was something more. I could sense a cultural thing that I had not experienced before. There was a feeling that individuals mattered and, maybe even more importantly, the company mattered to all the individuals. I believe this culture is due in large part to the ESOP structure. Everyone has ownership, so you know your extra efforts are worth something. There is also a sort of automatic policing that happens in this environment; I know the guy next to me is an owner, so I know he is not going to be to happy if I goof off and vice versa. This makes the entire organization very strong and by on large everyone performing at top notch.

Now that I have been here a while, is it all true? While it would be nearly impossible, in my opinion, to ever find perfection, I can say that Reflexite is the best company I have had the pleasure to work for **and** own.

My name is Joe Baron and I joined Reflexite in 1978, I am an XP Coordinator.

Twenty-four years ago, I started on second shift with a workforce of 20 people. The company has come a long way.

Years ago there was no 401(k) Plan, no ESOP, just a regular work force. The company has grown into a healthy, educated global company.

I take great pride in our workforce. The company's training programs have educated our employee-owners in safety, health, 401(k), ESOP to name a few. With even the member

companies on Global ESOP, I was able to buy a house, send my daughter through College. I was able to start a 401(k) Plan and diversify some of my ESOP money and stocks. I really take pride and ownership in this wonderful company. They have treated me and the rest of the people that work here just like a big happy family.

There should be more companies out there just like Reflexite, and many more ESOP companies, that take care of their employees.

It is a pleasure to work at Reflexite and I look forward to many more years.

Chairman HOUGHTON. Thank you very much. Ms. Thomas?

STATEMENT OF DELORES L. THOMAS, PRESIDENT, EWING & THOMAS, INC., NEW PORT RICHEY, FLORIDA, ON BEHALF OF THE ESOP ASSOCIATION

Ms. THOMAS. Mr. Chairman and Members of the Oversight Subcommittee of the House Ways and Means Committee, my name is Dee Thomas, and I am honored to speak today on behalf of the employee ownership, particularly employee stock ownership plans or ESOPs. I am President of Ewing & Thomas, a 100 percent employee-owned physical therapy company through an ESOP with 22 employee owners in New Port Richey and Sebring, Florida.

Mrs. Ewing and myself started the company in 1969. In 1988, I became seriously ill, and we sought an exit strategy. It just did not seem right to sell the company out from under the employees, so we sold it to the employees. Since then, employee owners at Ewing & Thomas at all levels sit on our board of directors. We honor a one person, one vote system, and we have put eight employees through college. The employee owners of Ewing & Thomas are in their ESOP for the long haul, fully aware of the risks of ownership but willing to work for the right of participation and the reward of retirement security.

While Enron's collapse is tragic in its effect on its employees, I believe we now have a golden opportunity to put a positive focus on employee ownership in America. I believe that as this Committee gives this subject its objective review, as did the Joint Committee on Taxation, it will ratify this nation's policy of encouraging employee ownership in a free enterprise society. We urge you to not be hasty or rush to judgment in reaction to this one company's tragedy while potentially undermining one of the great stories of America's strong and unparalleled economy, employee ownership.

If this Committee adopts new rules restriction company stock in KSOPs (ESOP with 401(k) feature) or new, quicker diversification rules, or new rules for public companies, whether KSOPs or standalone ESOPs, you will be slowly but surely unraveling some of the foundation of employee ownership that this Committee historically and with wisdom in the past has protected.

As a small business and in an area where employment retirement security is the weakest, I ask for your sensitivity in making laws and regulations so complex that the hoops and loops will prohibit employer participation in a retirement savings system. As an advocate of employee ownership, as an advocate of expanding employee ownership not only in this country but beyond our borders, as someone who truly believes that making ownership be the privilege of a few is detestable in a free and democratic society, I urge you not to take action that will undermine ESOPs and employee stock ownership in America.

[The prepared statement of Ms. Thomas follows:]

Statement of Delores L. Thomas, President, Ewing & Thomas, Inc., New Port Richey, Florida, on behalf of the ESOP Association

Mr. Chairman, and members of the Oversight Subcommittee of the House Ways and Means Committee, needless to say I appreciate and I am honored that as you review our nation's tax laws that apply to our tax qualified deferred compensation plans, or ERISA plans, you would want to hear from a representative of the employee ownership community, particularly employee ownership through employee stock ownership plans, or ESOPs.

As noted, I am Dee Thomas from the 100% ESOP company, Ewing & Thomas, an independent physical therapy provider in New Port Richey, and Sebring, Florida. My official title is President of Ewing & Thomas, and I still work daily in literally a "hands-on" capacity with patients in Florida's Fifth District.

In 1988 we became an ESOP company. Mrs. Ewing and I began the company in 1969. Mrs. Ewing is 20 years older than I, and I had become seriously ill. We needed an exit strategy; and although we nearly sold out, we felt uneasy selling the company out from the employees. So we sold to the employees through an ESOP. I own no stock, and have no stock options in Ewing & Thomas. We have 22 employees, and they participate in the ESOP as owners.

Clearly we would not be here today except for the unprecedented, and from my vantage point in New Port Richey, unfathomable, collapse of Enron. While tragic in its impact on Enron employees, the people of Houston, and on our nation's faith in financial reporting procedures, we in the employee ownership community now have a golden opportunity to put a positive focus on employee ownership programs in the United States.

And we believe that if that focus is objective in its review, this nation will not go down the path of making ownership the privilege of a few, but actually ratify this nation's policy of encouraging employee stock ownership programs, while recognizing both the risks, and the rewards of ownership among many in a free enterprise society.

While many might scoff at this statement, I want to make a point that many of us feel in the employee ownership world. We believe the United States has more employee ownership than any other nation in the world, and employee ownership has grown and become more accepted since Congress sanctioned employee stock ownership plans in 1975. While one can pick up books, articles, and speeches by many so-called thought leaders in the 70's and 80's predicting that the United States would soon play an economic third fiddle to nations of Asia, particularly Japan, and a unified Europe, the fact is that in the last 15 years our economy has outperformed all other nations, and we are second fiddle to no one in the strength of our economy. We believe that there is direct relation between the amount of employee stock ownership in the United States, and the success our nation has experienced compared to other industrialized nations of the world.

If our belief that there is a relation between our economic strength and economic democratization through more employee stock ownership is correct, then you can understand why we are so afraid that there will be a hasty rush to judgment in reaction to the Enron collapse that will undermine one of the great stories in America the past 25 years—more economic democratization through our ESOPs, 401(k) plans, and other forms of compensating with company stock.

I come today to highlight some data about the ESOP and employee ownership world, to help you make decisions on some difficult issues involving our ERISA plans, particularly defined contribution plans with company stock.

But I do not wish to be repetitive to the very excellent document prepared by the Joint Committee on Taxation *Present Law and Background Relating to Employer-Sponsored Defined Contribution Plans and Other Retirement Arrangements,* February 26, 2002.

Unlike media reports on company stock and the Enron fiasco, the Joint Committee clearly spells out that employee stock ownership can be a good thing for a variety of reasons, and that retirement income security can be a good thing as well, but that there is tension between the goals of employee stock ownership and retirement income security. Your job is to decide the specifics of our programs, whereas the media reports seem to imply that the only issue facing Congress and the Administration is retirement income security, and who cares about employee stock ownership?

Obviously, as an advocate of employee ownership, as an advocate of more employee ownership, not less, as someone who really believes making ownership be the

privilege of a few is detestable in a free and democratic society, I urge you to not take action that will undermine ESOPs and employee stock ownership.

There is some confusion about the various forms of employee stock ownership, and some pundits, and even some elected officials, say that they love employee ownership, but do not wish to see employee ownership be part of our ERISA system through ESOPs. Such a view, while well intentioned, would lead this nation to having as little employee ownership as most of our world-wide competitors, and is thus short sighted.

Truly, there is only one ERISA plan that Congress has specifically declared is an employee stock ownership program as well as a retirement income security program, and that plan is the ESOP. Because of this Congressional decision, there are special rules that apply to company stock in ESOPs that do not apply to company stock in other plans. The Joint Committee document spells out the special rules applied to ESOPs that make them more ownership plans while also balancing the desire to have them remain ERISA plans.

And the Ways and Means Committee can take pride that this committee, contrary to what some casual observers think, has led the way in structuring our ESOP laws, particularly the laws making ESOPs better ownership plans and better retirement security savings plans. For example, there is much debate with regard to diversification of company stock in public companies with ESOPs. The current law of permitting 50% diversification for ESOP participants age 55 with 10 years of participation in the ESOP was adopted by the Ways and Means Committee in October 1985. In the ESOP world, we call this amendment, the "Anthony" amendment after former Congressman Beryl Anthony, who authored the amendment. It was adopted with only one vote in opposition. It was proposed, and this is relevant, as a substitute for a proposal from then Chair Dan Rostenkowski that provided for diversification of ESOP stock after five years.

This is the fifth time this Oversight Subcommittee has examined ESOP law since 1986. So, Mr. Chairman, when we ESOP advocates come before Ways and Means and the Oversight Subcommittee, we know we will be heard.

But Ways and Means is not a Johnny-come-lately to company stock issues. In the 1920's, the committee sanctioned the use of company stock in tax-qualified deferred compensation plans. Many U.S. corporations have used company stock as compensation since the 19th century. And let me say right here that no one can point to any period of time of in our history since then—a time of one depression, many recessions, and boom times—when a significant number of elderly Americans were living in poverty or dire straights because their companies' compensated them in some manner with stock in the company.

Right now a common arrangement is having company stock be contributed to an ESOP in a relationship to a 401(k) plan, or what is called a K–SOP. If you studied each of the many "Enron" response bills pending, nearly all seek to change the rules for when an ESOP is operated in conjunction with a 401(k) plan.

And there is confusion about stock options that are broadly available to employees. Stock options are still primarily a compensation tool for the highly paid, while permitting it for all employees has grown in the decade of the 90's.

Let me make one clarification right now: Stock contributed to an ESOP is accounted for on financials as a compensation cost on an income statement. Too many of the media reports are confusing the accounting treatment of stock options with the accounting treatment of ESOP contributions.

Some companies talk about stock purchase plans, which are very similar to stock option plans in that an employee might purchase stock at a discount compared to current market value.

But for your purposes, the focus should be on ERISA plans; again, the Joint Committee document adequately explains how company stock, what kind of company stock, and what kind of plans are all involved with company stock, and how use of company stock relates to the rules and laws of ERISA.

The primary controversy is over 401(k) plans and ESOPs; in particular, 401(k) plans and ESOPs that are funded with employee contributions and employer contributions in coordination.

Every bill introduced in response to the Enron collapse has a "carve" out for ESOPs, in varying degrees.

For example, the Administration bill, as introduced by your colleague Congressman Sam Johnson, provides that there is no change in current law with regard to "stand alone" ESOPs.

Your committee colleagues Congressmen Portman and Cardin provides that there will be no change in current law with regard to ESOPs sponsored by privately-held corporations, which in reality means about 90 to 95% of the ESOP programs in America, covering we estimate about 3 million employees. Probably the bill that

caused the most controversy, the bill by Senators Boxer and Corzine, did not apply caps on employer securities held by ESOPs.

To give a feel for what are the various ERSIA plans sponsored by ESOP companies, I share data from a survey done recently by The ESOP Association: 19% of the ESOP companies only sponsored an ESOP; 29% of the ESOP companies in the Association sponsor an ESOP and a 401(k) plan that has no employer match, and no employer stock among the options for employee deferrals; 41% of the ESOP companies sponsor an ESOP, and a 401(k) plan with a company match in cash, but not in company stock, and there is no company stock as an option for deferrals; 12% of the ESOP companies in The ESOP Association sponsor a K–SOP, and of this number, among our Association members, who are 97% privately held corporations, 90% were private corporations.

Thus, if the committee adopts new rules restricting company stock in K–SOPs, or new quick diversification rules for K–SOPs, or new rules for public companies but not private companies with ESOPs or K–SOPs, you will be unraveling some companies employee stock ownership plan.

No one argues every law is carved in stone; no one argues that each tough question you face when you legislate is either/or. But, in alliance with the Coalition of Employee Retirement Benefits, or CERB, which was founded by our Association, the Chamber of Commerce, National Association of Manufacturers, the ERISA Industry Committee, the American Benefits Council, and the Profit Sharing/401(k) Council, we do say that if Congress changes laws with our 401(k) programs and our ESOP programs, you will have an impact that may be negative on employee stock ownership and the voluntary retirement savings system. (Please see Exhibit 1).

And, I want to conclude with this point. The facts are right in front of you from the Joint Committee document. Don't believe that what the media is saying that "most" Americans used to be in defined benefit plans, and that now "most" Americans are now in defined contribution plans where their future is at risk because of company stock.

The truth is before you in the Joint Committee document: **Most** American employees are not in any kind of ERISA plan. **Most** American employees were never in defined benefit plans. The fact is that coverage of more employees should be a major goal of our voluntary retirement savings system, not nitpicking and putting new restrictions on our defined contribution plans that have actually increased coverage.

This committee last year pushed to successful enactment the wonderful Portman-Cardin bill, which had near unanimous support in both Houses of Congress.

As a small business, which is what most American businesses are, and is the area where coverage of employees is weakest, we cannot afford to go through hoops and loops, to spend more and more of our hard-earned dollars on complying with ERISA, or on fees paid to money managers, instead of helping our employees save for the future. Let me assure you, sponsoring an ESOP, or a K–SOP means many dollars are being used to make sure we comply with the law. I know of other small business people who have an ESOP, or dropped their ESOP because of administration costs and complexity.

And for our friends in bigger businesses, either private or public, sure they might be able to afford spending more, but their share of the American workforce is not expanding as it is among small employers where expanded coverage is needed. And, while the bigger employers might be able to spend more to have their K–SOPs, their employees, just like the employees in a small company, will get less when more and more money of the company goes to outside vendors for compliance costs.

So, it is somewhat frustrating to hear of the "crisis" in America that our workers are at risk of living in poverty because of company stock in defined contribution plans, when there is no historical evidence that this is the case, even with some highly publicized bankruptcies. It is frustrating to think that the reaction of Congress and the Administration is one that has a high chance of taking us down the road of less coverage by ERISA plans, and even less employee ownership, leaving us as a nation truly more dependent on Social Security for the majority, while ownership becomes even more the privilege of a minority—the privileged few.

Now I would like to turn over my time to my good friend Karen York, to give a perspective not of a top executive, or pension expert, but of an employee owner, who works on the front line of employee ownership everyday she goes to work at Scot Forge. Karen,

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Exhibit 1

COALITION ON EMPLOYEE RETIREMENT BENEFITS
Protecting the American Dream

February 25, 2002
Representative Amory Houghton
United States House of Representatives
1111 Longworth House Office Building
Washington, DC 20515

Dear Representative Houghton:

On behalf of hundreds of thousands of American businesses that offer retirement benefits to workers, we are writing to urge you to proceed with caution before making any changes to current retirement policy. Our nation's voluntary retirement savings and employee ownership programs are a great success, but ill-conceived legislation and regulation could put the benefits of many workers in jeopardy.

Currently, 56 million American workers participate in 401(k), profit sharing, and employee stock ownership plans (ESOPs). Pension legislation enacted in June 2001 should increase that number. One of the hallmarks of the current system—flexibility for employers to design a benefits package that is most appropriate for their workers—is a crucial component to the system's success.

We are concerned that various elements of retirement bills currently pending before Congress may unintentionally harm workers' ability to save for their retirement. For example:

- Percentage caps, limits on holding periods, and diversification mandates will limit employee choice and deter employer matches. Millions of workers have benefited from the ability to invest in company stock. Imposing a one-size-fits-all approach by limiting certain investment choices—most notably company stock—will hurt many workers who strongly support their ability to make their own investment choices. We urge Congress to focus instead on encouraging investment education and professional investment advice so that workers have the tools to make wise retirement planning decisions.
- Arbitrary restrictions on transaction suspension periods (also known as "blackouts" or "lockdowns") could interfere with the normal process of improving 401(k) plan administration. Transaction suspension periods help ensure the orderly transfer of data between plan recordkeepers, and often help to increase participants' plan options (such as increasing the number of employees' investment choices or frequency of trading capabilities).
- ERISA mandates a strict level of fiduciary behavior for plan sponsors and provides stringent sanctions for any violations. Any proposals to change that framework will impact costs for plan sponsors and participants and will have a chilling effect on efforts to expand pension coverage for workers.

In the ensuing months, we urge you to proceed with caution in making any changes to current retirement policy. In order to ensure the retirement security of American workers, it is
critically important to make sure that the positive trends in retirement coverage continue instead of letting an unprecedented event like the Enron collapse lead us to misguided and potentially damaging responses.

For more information on these issues, or if you have any additional questions, please have your staff contact CERB Steering Committee members James Delaplane of the American Benefits Council (202–289–6700), Janice Gregory of the ERISA Industry Committee (202–789–1400), Michael Keeling of The ESOP Association (202–293–2971), Dorothy Coleman of the National Association of Manufacturers (202–637–3077), Ed Ferrigno of the Profit Sharing/401(k) Council of America (202 626–3634) or Kathleen Havey of the U.S. Chamber of Commerce (202–463–5458).

Sincerely,

American Benefits Council
The ESOP Association
The ERISA Industry Committee
National Association of Manufacturers
Profit Sharing/401k Council of America
U.S. Chamber of Commerce
3M
AbleNet, Inc.
Acadian Ambulance Service, Inc.
ACE Clearwater Enterprises
Ace Trucking Company, Inc.
Advanced Distributions, Inc.
AeA (American Electronics Association)
Aerotech, Inc.
Agilent Technologies, Inc.
AGVISE Laboratories, Inc.
Alcoa, Inc.
Alexander Marketing Services, Inc.

All American Turf Beauty, Inc.
ALLETE
Alliance Benefit Group
Alliance Foods, Inc.
Alliant Energy Corporation
Allied Plywood Corporation
Alpha Beta Press, Inc.
Alterman Management Group, Inc.
Aluminum Association
American Ambulance Providers, Inc.
American Bankers Association
American Business Forms, Inc.
American Commercial, Inc.
American Gas Association
American Movers, Inc.
American Systems Corporation
Ameritas Life Insurance Corporation
AMT—The Association for Manufacturing Technology
Analytech Consulting Resources
Ancon Construction Company
Anderson & Associates, Inc.
Anderson Tool & Engineering Company
Antioch Company
Appleton Papers, Inc.
Applied Materials
Appraisal Technologies, Inc.
Arch Coal, Inc.
Arlee Home Fashions, Inc.
Armfield, Harrison & Thomas, Inc.
Armstrong World Industries
Ashland Inc.
Aspen Systems Corporation
Associated Benefits Corporation
Associated General Contractors of America
Association of Equipment Manufacturers
Association of Washington Business
Automated Packaging Systems, Inc.
Avaya Inc.
Aventis Pharmaceuticals
Ayers Associates, Inc.
Bank of Utah
Barker Company, Ltd
Barker Phillips Jackson, Inc.
BASF Corporation
BeckDurell Creative, Inc.
Beckman Coulter, Inc.
Bellevue State Bank
Benefit Concept Systems, Inc.
Benefit Solutions Company
Benefits Concepts of Indiana, Inc.
Bensym, Inc.
Berkeley Policy Associates
Bertotti Landscaping, Inc.
BFW Construction Company
BISYS Retirement Services
Blachford Corporation
Blount Construction Company, Inc.
Bobbitt and Associates, Inc.
Bollinger Insurance, Inc.
Border States Electric Supply
Bridge Community Bank
Bridgestone/Firestone, Inc.
Brockway-Smith Company
Buck Consultants, Inc.
Building Materials Distributors
Burrus & Matthews, Inc.
Butler Manufacturing Company
Cable Constructors, Inc.
Cal-Air, Inc.
California Eastern Laboratories
Camber Corporation
Capital Associated Industries, Inc.
Capital Fire Protection Company
Cargill Incorporated
Carly & McCaw, Inc.
Carters, Inc.
Caterpillar Inc.
CBIZ Business Solutions
C–CUBED Corporation
Celanese Chemical Company, Ltd.
Cellusuede Products, Inc.
Central Indiana Hardware Company, Inc.
Central Moloney
Central Virginia Industries, Inc.
CH2M HILL
Challenge Manufacturing Company
Chardon Laboratories, Inc.
Charlton Manley, Inc.
CHART Rehabilitation of Hawaii, Inc.
ChemTreat, Inc.
Cianbro Corporation
Cinergy, Corporation
Claremont Flock Corporation
CNF Inc.
Cobb, Fendley & Associates, Inc.
Colonial Carton
Colovos Company
Color Design Art
Columbia Quarry Company
Communications, Cabling & Networking
Community Bancshares, Inc.
Compass Bank
Consolidated Electronic Wire
Consolidated Freightways Corporation
Construction Specialties, Inc.
Continental Custom Ingredients, Inc,
Control Technology, Inc
Controlled Blasting, Inc.
Corte Construction Company
Council of Industry of Southeastern New York
Council of Insurance Agents & Brokers
Cowden & Associates
Creative Direct Response
Crocker Marine Group, Inc.
Crookham Company
Cross & Associates
Cummins-Wagner Company
CYRO Industries
Darmann Abrasive Products
David H. Paul, Inc.
David Volkert & Associates, Inc.
DCS Corporation
Design Containers, Inc.
Design Craftsmen, Inc.
Dimensions International, Inc.
DIPACO, Inc.
Douglas Machine, Inc.
E & I Acquisitions LLC
Eagleware Corporation
Eastman Chemical Company

Eastman Kodak Company
Ecker Enterprises
Ecolab Inc.
EDS
Eggelhof, Inc.
Ellin & Tucker, Chartered, Business Valuation Services
ELS, Inc.
Empire Valuation Consultants, Inc.
Employee Benefit Management Corporation
Employers Association of the NorthEast
Employers Council on Flexible Spending
Environmental Science Associates
EPL, Inc.
Eriez Manufacturing Company
ESOP Services, Inc.
ESOP Small Business Services
Evapco, Inc.
Ewing & Thomas, Inc.
Facile Holdings, Inc.
Fairfield Engineering Company
Fast401k, Inc.
Fastener Industries, Inc.
FGM, Inc.
Fiduciary Capital Management, Inc.
Financial Executives International
First Command Financial Services
Fisher Tank Company
Fleetwood Group, Inc.
Flexsys America L.P.
FMC Technologies, Inc.
Foldcraft Company
Follett Corporation
Foresight Technology Group
Fortune Hotels, Inc.
Fox Entertainment Group
FP Industries
FPL Group, Inc.
Freeman Companies
G & M Electrical Contractors Company
Gala Industries
Gallo Displays, Inc.
Ganahl Lumber
Gardener's Supply Company
Garney Holding Company
General Technology Corporation
Geologic Services Corporation
Georgia-Pacific Corporation
Gerald H. Phipps, Inc.
Gipe Associates, Inc.
Goelzer, Inc.
Granco-Clark, Inc.
Gray, Harris & Robinson, PA
Great Lakes Pension Services, Inc.
Green Light Company
Greenville Tool & Die Company
Gripnail Corporation
Grocery Manufacturers of America
Guidant Corporation
Harsco Corporation
Haywood Builder's Supply
HDR, Inc.
Heat Transfer Equipment Company
Hercules Chemical Company, Inc.
Hewlett Davidson & Associates, LLC
Hi-Speed Industrial Service
HISCO, Inc.
Holmes Murphy & Associates
Hon Industries Inc.
Honeywell
Horizon Bancorp
Hormel Foods Corporation
Houchens Industries, Inc.
Howell's Heating & Air Conditioning
Hoy Construction, Inc.
Humboldt Land Title Company
Hypertherm, Inc.
ICI Americas, Inc.
Idaho Pacific Lumber Company
Illinois Tool Works Inc.
IMC Global Inc.
Independent Insurance Agents of America
Industrial Spring Corporation
ING US Financial Services
Inland Truck Parts Company
Intel Corporation
Intercontinental Terminals Company
International Mass Retail Association
International Parking Design
Invesmart
IPC, Association Connecting Electronics
Isco, Inc.
J. E. Sawyer & Company, Inc.
J.H. Bennett & Company, Inc.
J.R. Holcomb and Company
J.R.'s Good Times, Inc.
JELD–WEN
Jochim Company, LPA
Johnny's Pizza House, Inc.
H. Muehlstein & Company, Inc.
H.W. Lochner, Inc.
HA&W Benefit Advisors, LLC
Haag Engineering Company
Haldeman Homme, Inc.
Harley-Davidson Motor Company
Harrell Remodeling, Inc.
National Association of Health Underwriters
National Association of Insurance and Financial Advisors
National Association of Independent Insurers
National Association of Wholesaler-Distributors
National Bank of Indianapolis
National Bureau of Property Administration, Inc.
National Council of Chain Restaurants
National Employee Benefits Institute
National Fruit Product Company, Inc.
National Restaurant Association
National Retail Federation
National Roofing Contractors Association
National Stone, Sand & Gravel Association
National Telephone Cooperative Association
NCR Corporation
Nestlé Purina PetCare Company
New River Electrical Corporation
News Press & Gazette Company
Nicholville Telephone Company, Inc.

Nixon Peabody LLP
North Star Trust Company
Northern States Industries, Inc.
Northwest Ohio Pension and Retirement Services
Northwest Spring and Manufacturing Company, Inc.
NPES The Association for Suppliers of Printing, Publishing and Converting Technologies
NW Healthcare Alliance, Inc.
O. Smith Corporation
O'Neil Industries
O'Neil Printing, Inc.
Once Again Nut Butter, Inc.
Optical Research Associates, Inc.
Orange Chamber of Commerce
Orthodyne Electronics
Osborne Industries, Inc.
Osmose, Inc.
Ownership Visions, Inc.
Oxygen Service Company
Panel Processing, Inc.
Panelmatic, Inc.
Parksite, Inc.
Pasadena Center Operating Company
Patio Enclosures, Inc.
Pavement Recycling Systems, Inc.
PBI/Gordon Corporation
PEMCO Corporation
Pension Specialists, Inc.
Pension Trend, Inc.
Peterson Machine Tool, Inc.
PI, Inc.
Pioneer Power, Inc.
Planning and Management Consultants, Ltd.
Plastic Suppliers, Inc.
Pleune Service Company
Power Curbers, Inc.
PPG Industries, Inc.
PPC Mechanical Seals
Praxair, Inc.
Praxis Consulting Group
Precise Products Corporation
Precision Grinding, Inc.
Price Brothers Company
Principal Financial Group
Pro-Ben Services
PSOMAS
PTC Alliance Corporation
Publix Super Markets
Pumping Services, Inc.
Purity Cylinder Gases, Inc.
Quick Lube of San Rafael and Santa Rosa
Quick Solutions, Inc.
Quincy Castings, Inc.
R.K. Schaaf Associates, Inc.
R.W. Smith & Company
Radiometer America, Inc.
Railside Enterprises, Inc.
Rainbow Disposal Company, Inc.
Ramsey Financial Corporation
Raskin Benefit Advisors, LLC
Raths, Raths & Johnson, Inc.
RBP Chemical Corporation
Red Dot Corporation
Reel Precision Manufacturing Corporation
Regal Service
Reproductions, Inc.
Republic Mortgage Insurance Company
Restek Corporation
Retirement Specialists, Inc.
Reuther Mold & Manufacturing Company
Ritchie Corporation
Riverside Mattress Company, Inc.
RJN Group, Inc.
RLI Corporation
Robins & Weill, Inc.
Ronco Engineering Sales, Inc.
Roscoe Moss Company
Roush Equipment, Inc.
Roy F. Weston, Inc.
Ruane Associates, Inc.
Rubber Manufacturers Association
Rudyard Cooperative Company
Ruekert & Mielke, Inc.
SAIC
Saint-Gobain Corporation
Salt Institute
Sandmeyer Steel Company
Schaedler/YESCO Distribution, Inc.
Schafer Systems, Inc.
Schnectady Steel Company, Inc.
School Services of California
Scot Forge Company
Scott Insurance
Scotty's Contracting & Stone, LLC
Security Supply Corporation
Security Trust Company
Sentry Equipment Corporation
Shared Equity Strategies, Inc.
Sharon Heights Care and Rehab
Sharon Manufacturing, Inc.
Shooshanian Engineering, Inc.
Simmons First Trust Company, N.A.
Slakey Brothers, Inc.
Snap Drape International, Inc.
Society for Human Resource Management
Southern Rubber Company, Inc.
Southern States Cooperative, Inc.
Southern Tier Insulations
Southco, Inc.
Specialty Equipment Sales Company
Spectra-Mat, Inc.
Springville Mfg.Company, Inc.
Stevenson & Palmer Engineering, Inc.
Stewart's Shops Corporation
StorageTek
Stora Enso North America
Stylmark, Inc.
Sunnen Products Company
SunTrust Banks, Inc.
Superior Plating, Inc.
Superior Plumbing & Heating, Inc.
Susquehanna Pfaltzgraff Company
Swales, Inc.
Sylvin Technologies, Inc.
TD Industries, Inc.
Telect Inc.

Teleflex Incorporated
Texas Association of Business & Chambers of Commerce
The Cadmus Group
The Dexter Company
The Financial Services Roundtable
The Manufacturers Assoc. of Mid-Eastern PA
The National Underwriter Company
The Pearl Group, LLC
The Pennock Company
The Pension Reform Action Committee
The Perrier Group of America, Inc.
The Ruhlin Company
The Strategy Group for Media
The Sundt Companies, Inc.
The Timken Company
The Woodlands Operating Company L.P.
Thoits Insurance Service, Inc.
Thomas Rutherfoord, Inc.
Thompson Engineering
Thorson West
Toll Gas Company
Towers Perrin
TPM Resource Solutions
Tredegar Corporation
Trinity Steel Fabricators, Inc.
Twin Modal, Inc.
Unette Corporation
Unified Trust Company, NA
United States Steel Corporation
USA 800
Utah Manufacturers Association
Value Plastics, Inc.
Varied Investments, Inc.
Vector Technologies, Inc.
Vermeer Equipment of Texas, Inc.
Veterinary Service, Inc.
W.R. Grace and Company
Wainwright Industries, Inc.
Waltco Engineering Company
Washington West Apartments LLC
Weaver Quality Shutters
Weldon Machine Tool, Inc.
Welsch, Flatness and Lutz
Western Contract Furnishers
Wexco, Inc.
Whirlpool Corporation
WIKA Instrument Corporation
Williams & Works, Inc.
Williams Panel Brick, Inc.
Willis
Wilson Construction Company
Windings, Inc.
Wisconsin Manufacturers & Commerce
Wm. W. Meyer & Sons, Inc.
Womble Carlyle
Wood Truss Council of America
Woodruff-Sawyer & Company
Woodward Communications
Woodward Governor Company
Young Electric Sign Company
Your Building Centers, Inc.
YSI, Inc.
Zenith Engraving Company
Zimmerman Associates, Inc.

Exhibit 2

Set forth below are 34 "success" stories (14%) of the total responses received in from a 17-question e-mail survey, regarding plan structure. The survey was distributed among The ESOP Association's approximately 1250 company members, with a request that the responses be submitted within 72 hours, and that no one provide individual balance information they were not comfortable sharing. Under the tight deadline, and with several respondents preferring not to disclose account balance information, the following 34 examples were selected. Out of the 250 responses, nearly 50 indicated that the ESOP was less than five years old, and thus balances had not been built up.

The statistical results of the survey are provided on another document.

1. McKay Nurseries, Waterloo, Wisconsin. Private company. Won 1996 National Business Enterprise Award for its inclusion of migrant workers in its ESOP and benefits programs. Last December distributed $2,000,000 as follows: Monsies Gomez, $484,000, digging crew leader; Marv Frey, $406,000, nurseryman; Charles Benisch, $516,000, truck driver; and Victor Molina, $321,000, farm chemical applicator. Two employee owners, non-management, currently have balances over $1 million. All are retired, and would be honored to speak to Congress.
2. Kelso-Burnett Company, Rolling Meadows, Illinois. Private company. Construction estimator, balance in plan, $1,000,000; Purchasing agent, balance in plan $700,000; Safety director, former receptionist, balance, $490,000; Construction project manager, retired in 1999 with $1,050,000 distribution.
3. RLI Corporation, Peoria, Illinois. Public company. Average employee retires with account balance that is 10 times annual salary.
4. Bridge Community Bank, Mechanicsville, Iowa. 15 employees, paid out to the few retirees since 1990, all non-management, over $1,000,000 in total. Quote, "It would be a crime if a company such as Enron had an impact on our success and took the opportunity to share the wealth away from our employee-owners."

5. SnapDrape, Carrolltown, Texas. Private company. Has paid out 29 employees since ESOP began in early 90's. Of 29, 26 paid between $330,000 and $1,000,000. One payout of $110,000, and two, barely vested, left with just under $20,000.
6. Scotts Insurance, Lynchburg, Virginia. Private company. With workforce with average pay of $30,000 to $40,000, average payout from ESOP to non-management employees is $1,000,000. Two earners in company, which is small sales staff, will retire with over $2 million.
7. Chardon Laboratories, Reynoldsburg, Ohio. Private company. ESOP only four years old. Blue-collar workers have already accumulated 1 times annual pay. Average in 401(k)—few participated, and those that did had much less than annual pay.
8. Alterman Management Group, San Antonio, Texas. Private company. Very small, but last year, project manager retired with $850,000 from ESOP, and $125,000 from 401(k), and purchasing agent with $500,000 from ESOP, and $100,000 from 401(k).
9. Columbia Quarry Company, Columbia, Illinois. Private company. Those with 10 years of service have received up to $1,500,000 distribution from ESOP.
10. New River Electrical, Cloverdale, Virginia. Private company. Two non-management employees retired last year with ESOP distributions over $500,000.
11. Beacon Technologies, Atlanta, Georgia, Private company. Employee retired last year, who never made more than $30,000 per year with ESOP distribution of $450,000.
12. Fleetwood Group, Holland, Michigan, Private company. Joyce retired last year with an over $1,000,000 distribution from ESOP. Joyce was an hourly worker.
13. King Arthur Flour, Norwich, Vermont. Private company. Relatively new ESOP, a few years, employee terminated this year with over $250,000 in account.
14. Stylmark, Inc., Minneapolis, Minnesota. Private company. Over years, common for lower paid employees to retire with well over $100,000 in accounts.
15. Weldon Machine Tool, York, Pennsylvania. Private company. Typical truck driver with 10 years has over $100,000 in ESOP, with several over $200,000.
16. K.W. Tunnell, King of Prussia, Pennsylvania. Man left one company after 15 years, with no retirement. Worked less than 13 years at Tunnell, and retired with $278,000.
17. Garney Companies, Inc., Kansas City, Missouri. Private company. Laborer out of high school, with 17 years in ESOP, now a superintendent, has over $1,000,000. Similar person, laborer most of his career, left some years back with over $550,000.
18. Cummins-Wagner, Annapolis Junction, Maryland. Private company. Last two years, $3 million distributed to 15 departing employees.
19. Green Point Savings, Lake Success, New York. Public company. In addition to company's pension and 401(k) plans, ESOP provided $400,000 to mid-level manager retiring last year, and over six years to clerical worker retiring last year.
20. Media Loft, Minneapolis, Minnesota, Private company. Has allocated over $5,500,000 in six years to all employees from a work force never larger than 52 employees.
21. Builders Supply, Omaha, Nebraska. Private company. Many employees from non-management ranks retired in past few years with distributions ranging from $100,000 to $500,000.
22. Lowe's Corporation, North Wilksboro, North Carolina. Public company. Published reports are of over 200 mid-level to low pay employees retiring with over $1,000,000 in the last 30 years.
23. Western Contractors, Rancho Cordova, California. Private company. Raymond Roelofs, warehouse employee, retired with over $500,000 in ESOP distribution.
24. Chaska Chemical, Savage, Minnesota. Private company. Several employees had accumulated around $40,000 in diversified 401(k)'s from 1984 through 1994, and then the ESOP was installed. In seven years these employees' accounts are $250,000 and over. Employees are in late 40's and 50's now.
25. Southern Rubber Company, Greensboro, North Carolina. Private company. A testimonial: "After 7 years a number of our employees have accumulated sizable account balances. Clearly they have larger balances than if the com-

pany had continued with the prior profit sharing plan. The employees also have a job and future that they may not have had if the company was sold by the prior owner to an outside investor."

26. Antioch Company, Yellow Springs, Ohio. Private company. 23 balances over $1 million. 26 balances over $500,000. These 49 balances are all non-management employees.
27. Minnesota Power, Duluth, Minnesota. Public company. In 20 years of ESOP, the average 20-year return on company stock in ESOP has been 17% per year!
28. Palos Bank & Trust, Palos Heights, Illinois. Private company. Since ESOP created in 1990, the appreciation of company stock in ESOP has been 750%!
29. Scot Forge, Spring Lake, Illinois. Private company. Lathe operator in machine shop, $783,818; machine operator, $478,576; maintenance mechanic, $881,073; forge shop supervisor, $814,716; electrical engineer, $660,489; final inspector, $603,303; press operator, $563,665; machine operator, $597,207; and sale and customer service $574,826.
30. Technical Assistance & Training Corporation, Washington, DC. Private company. 30 employees, revenues average $5.4 million, one employee has $310,000.
31. LeFiell Manufacturing, Santa Fe Springs, California. Private company. ESOP until recently less than 50% ownership among employees. Machine operators and machinists, 10 people, accounts from $100,000 to $200,000. (CEO started as machinist in 1962, ESOP created in 1974, account balance is near $900,000.) Around 140 employees total.
32. Woodward Communications, Dubuque, Iowa. Private company. Non-management employee, 8 years in ESOP, $54,328; Non-management employee, 9 years in ESOP, $52,126 in ESOP.
33. Ruekert & Mielke, Inc., Waukesha, Wisconsin. Private company. Individual with high school education started as laborer, retired before 65, with a $550,000 ESOP distribution.
34. Keller Structures, Kaukauna, Wisconsin. Private company. Salesman, 12 years, left company with $1,410,000 in ESOP. Salesman, 12 years left company with $670,000.
35. Ecker Enterprises, Chicago, IL. Private company. Accounts payable clerk, final year pay was $29,000. Left the company with a little over $400,000 in ESOP distribution.

We do not have data from non-ESOP companies. Prominent non-ESOP companies that supposedly have provided great wealth are Intel, Publix Supermarkets and Microsoft, to name a few. BNA, Starbucks and Southwest Airlines all have significant employee ownership.

For so many of the ESOP companies, the employee ownership style is more than the money. It is the culture, and almost the religion of the entity. Evidence are the few comments set forth below that recently were sent to The ESOP Association as companies learned that the Enron fall out would perhaps threaten their ownership culture:

> "The bigger success story for our 90-year-old engineering/architectural-consulting firm is the change in attitude in our firm. We are seeing an end to the "us versus them", "shareholder/non-shareholder" attitude. We are developing a culture of unified company rather than nine disjointed departments. We are seeing huge contributions from employees who would have previously preferred to not be involved or limit their involvement".
>
> Toltz, King, Duvall, Anderson & Associates, St. Paul, Minnesota

> "We are a new ESOP—However, we do have culture change success stories."
>
> Schaefer's Systems, Inc., Adair, Iowa

Exhibit 3

Note: As abbreviated below, "JMK" is J. Michael Keeling, host of the "Michael Keeling Talks Employee Ownership," which aired from June 2001—September 2001 on Providence, RI-based WALE 990 AM. Mr. Keeling is also President of The ESOP Association.

"Karen" is Karen York, Staff Accountant for Scot Forge Company in Spring Grove, IL, and a member of Scot Forge's ESOP Committee.

The following transcript is from a July 9th radio show, during which Mr. Keeling had Karen York as his guest. The text has been edited slightly to remove promotional material for The ESOP Association and WALE AM.

Michael Keeling Talks Employee Ownership

JMK—I am very excited to have as our guest Ms. Karen York from Scot Forge Company. For the past several weeks we have talked about quality of work, and balance in life/work, and how this plays into employee ownership. Welcome Karen.

Karen—Thank you Michael

Karen—My title is Staff Accountant—I also work with the ESOP Committee. Scot Forge is a manufacturer of rolled-die and rolled-ring forgings.

JMK—How long have you been with the company

Karen—For fifteen years.

JMK—And was Scot Forge ESOP when you came?

Karen—The ESOP was put in place in 1978, but did become really active until around 1984–1985. We were still an infant ESOP when I came.

JMK—What is the ownership structure?

Karen—We are a 100% employee-owned S Corporation ESOP—We have approximately 500 employees.

JMK—And Karen, what was the company's motivation in implementing the ESOP back in 1978?

Karen—The Chairman of the Board and his family owned all of the stock—he had inherited the company from his father. He felt that the hard-working employees should be rewarded for being so dedicated and for making the company so successful.

JMK—Did Scot Forge become 100% immediately?

Karen—No, Initially the prior owner donated about 20% and we have gradually purchased stock until 1997 when we became 100%.

JMK—When did the ESOP Committee start

Karen—In 1987 or 1988. We had been an ESOP for 10 years, but no one really knew much about what an ESOP really was or what it meant to the company. The real attitude of ownership that the seller hoped to foster was just not there. So he put together this committee in which employee's voices could be heard.

JMK—That is interesting. He was beginning to think about an ESOP Committee very early on.

Karen—He felt that the ideas that evolved from workers on the floor on a daily basis are more valid than those generated by upper-level managers.

JMK—You know I visit a lot of ESOP companies, and in companies where employees other than top-level managers are interested in share value, these companies tend to have ESOP Committees or Counsels. In fact, fostering that ownership culture is the "thing" to do among employee-owned companies. Before we continue, let's talk about your background? Did you start as staff accountant?

Karen—Yes. I had worked with my husband in a two-man business, and we both left and I went to work for Scot Forge. We felt a small business was too much pressure, so we sold it and I went to Scot Forge.

JMK—Were do you live? In the city?

Karen—No. We live on a 20-acre farm with hay and livestock—a town with 200 people (outside of Spring Grove). An upbeat town in our area has 500–1000 people.

JMK—I mention this because many of the people in your company are second and third generation farmers. They understand the attributes of ownership that are necessary to make a living which are synonymous to the attributes of ownership. They understand the things they own and need to take care of and nurture. And they recognize that they lose money if they do not.

Karen—That is true, Michael

JMK—In fact, I have heard said over the years, and this is not meant negatively to urban-dwellers, but that those who must nurture what they own, and make a living with their land and livestock tend to make very good employee owners. Now, if that was the only way that one became an employee owner, we would have very few employee-owned companies and employee owners. Have you every heard that thought before Karen?

Karen—No. I have not, but it makes sense that farmers understand ownership because of their rural backgrounds. For our company, the ownership culture has been easier to establish because people truly understand ownership of REAL property.

JMK—Because these people better appreciate and understand real ownership, it does not mean they are necessarily better employee owners. It just means they have the capacity to better understand. Now, I want to delve into Karen's experience at Scot Forge when we come back from the break.

JMK—Welcome back—Michael Keeling with The ESOP Association talking employee ownership. As we left the first segment, I was discussing with Karen some of the characteristics of employee owners, and some of the characteristics that make them good employee owners. I do not assume Karen that you came to Scot Forge planning to be active on the ESOP committee?

Karen—Absolutely not.

JMK—So how did you get involved?

Karen—When I started with the company, I knew I was getting good benefits and good pay—but after about one year, I noticed that something was different. I got the feeling that there was more camaraderie here than in other companies. I ran for the ESOP Committee once, and did not get elected. So, I ran again the following year and did get elected—the Committee was a really eye-opening experience.

JMK—How often do you meet and what do you discuss?

Karen—We meet once every other month. We have tried several different time scenarios, and this seemed to be most effective. Our primary focus is education. We learn as much as we can about ESOPs and employee ownership so that we can educate our fellow employee owners. Employee owners actually come to us with questions and we need to be equipped to answer their questions. If employees have problems, sometimes they are more comfortable talking to us than to the CEO. On the occasions when we cannot answer questions, we may bring in a member of the management team, but employee questions will always remain anonymous. It has worked really well.

JMK—So, one, it sounds like you are the "go-to" guys. How many on the committee?

Karen—Nine regular people, plus me. My term ended years ago, but because of my position right next to our CFO (who has all the answers), I have been asked to stay on as an educational resource. We elect one member/year from each of our plants to serve a three-year term.

JMK—Can people be re-elected?

Karen—Yes. At first, we wanted to give everyone a chance. But since, we have noticed that some people just have a tremendous amount of enthusiasm and are assets time and time again, so we amended the by-laws to allow people to seek reelection. Thus, we always have familiar and new faces.

JMK—You are an ex-officio resource then?

Karen—Yeah, I guess so.

JMK—You spoke of the committee's role in educating fellow employee owners about ownership. I think it represents how we are moving from our previous shows to trust, passion, etc—We want to help employees understand that the ESOP is just not for the top people in the company. Education is semi-laymen's terms of legal, administrative advice, etc—, and from what I understand from you, the committee serves as a liaison among all levels of staff with regard to legal and administrative updates. Does the committee also communicate financial information, business strategy, etc—to employee owners?

Karen—At Scot Forge, we share financial data with employees on a monthly basis. We have a "free" lunch every month, and the division managers break it down and explain how each division did. The ESOP Committee tries to help employee owners understand the numbers, and to help them understand income statements and balance sheets.

JMK—In other words, as is becoming a trend among a lot of closely held businesses, Scot Forge is practicing some form of open-book management, as far as the employees are concerned.

Karen—That is correct. We believe that if you are an owner, you need to see the numbers and understand the numbers.

JMK—You are also doing breakdowns of account statements, etc—and some of that is difficult to understand?

Karen—Yes, that is really where the ESOP Committee comes in. While many of us are not familiar with accounting standards, we educate ourselves and communicate to employees.

JMK—It would be interesting to learn how closely held companies that utilize open book management fare in the marketplace. After our break, we will consider take a look at this phenomena.

JMK—I am talking to Karen York, 1998 National Employee Owner of the Year for The ESOP Association. She is Staff Accountant for Scot Forge—she is not an upper-level manager. Prior to the break, we were talking about open-book management and how Scot Forge communicates company numbers to employees and non-accountants. Now Karen, many owners of closely held companies fear that if they share the books, that employees will go tell their neighbor, say it in church, or use it as leverage to get another job. Have you had any experience this?

Karen—No, not that we know of. We share the same information with everyone and try to ensure that they understand how the money is made and where it goes. We hope this means that employee owners will understand where they can save money and hope the company will overall be more profitable.

JMK—Sure—And this brings up another issue. Do employees know one another's salaries?

Karen—No, salaries are their own business. We share graphs and charts showing total sales dollars, and whether it is up or down and how that compares to the budget. We try to explain the different between raw sales numbers and profits. We also try to specifically explain where each employee owner fits into the budget, and where salaries and benefits fit, and where unforeseen mechanical breakdowns fit in. We do not breakdown salaries, though—that is how we break the numbers.

JMK—You mentioned training that the committee receives/gives in educating employee owners. How is this done?

Karen—We bring employees in during their orientation, and we give them an overview of the ESOP and a review of the vocabulary that will be used at the monthly meetings. We use a lot of slides and visual aids to assist in their understanding.

JMK—Without dwelling on open-book management, many in the ESOP world feel that it is crucial. Out of all of your workforce, are there some folks who just don't understand the financials?

Karen—Yes, there are a few. There will always be a few who just don't get it. There are also a few who do not care. But we do our best, and we get a lot of great questions, which indicates that people are learning and understanding as best they can, and want to learn even more. We just keep making the pitch that reaches the most people.

JMK—And that leads me to the bigger picture. Why is Scot Forge the way it is? Earlier in the shows, a lot of discussion has come up about the nature of work, and how work can be rewarding—we hear a lot about technology. Scot Forge does things they way they have been done for years. 500 Scot Forge employees are not sitting at home at midnight working on their computers, correct?

Karen—That's correct. Our company has been around for 108 years, and the industry has been around even longer.

JMK—I would assume then that this creates a great sense of pride among employee owners at Scot Forge. I would also assume it creates a great sense of responsibility and I would maintain that anyone who holds a job has some sense of responsibility. I still seem to feel that Scot Forge has a little something extra that in addition to being proud that you as an individual can do a good job.

Karen—Absolutely. You are not only producing the best parts you know how to produce. You come in and you do the best job you can—here at Scot Forge, you are an owner. You are building a company and building value in stock that you own.

JMK—This again brings us back to the human link that creates the kind of environment you read a lot of books about.

JMK—We have gone through Scot Forge, the ESOP, your job and open book management. You have been there for 15 years, do you think that people in Scot Forge have a passion for the company and for employee ownership?

Karen—Yes, I think so. Prior to this broadcast, we had an ESOP committee meeting, which was attended by several of the members of our Board of Directors. There was a new committee member—he is in first term—and he had that passion—he was questioning as to how anyone employed by Scot Forge could NOT love such a great company, especially a company that offered a chance to be an owner.

JMK—In earlier shows, we talked about having a passion for the jobs we do. You know, work dominates our lives. I know you and your husband have a passion for the work you do in the home. But really, our waking ours are spent doing a job we get paid to do, and having passion certainly makes it more enjoyable. What are some characteristics that lead to the passion?

Karen—Tough question. Here at Scot Forge, many of our workers never went to college. They learned the trade on-the-job. Thus, the passion comes more from the circumstances of the work. They are not just here to get a paycheck—they are saving for the future and the company will eventually pay them back.

JMK—A few weeks ago I wondered why so many employee owners are passionate about their work, and I think that a large number of employee owners have respect for one another. I think the CEOs in most of these companies have respect for all the employee owners.

Karen—If you work in a place where you feel you are respected, you can trust your co-workers. We consider ourselves equals in this company. No one is better than anyone else. Being in an employee-owned company generates a lot of enthusiasm for the company and for employee ownership,

JMK—I think that is linked, too. I understand that there are many great companies out there that are NOT employee-owned. But I think that when you walk into a company and hear there is ownership in the company, I think there is large-scale respect in that company. And that respect stays in place. Respect and trust fit well into companies with ownership structures. Taking a break.

JMK—Before closing out with Karen York, I want to mention that next week's guest will be Dr. Joe Blasi. We can show the world that employee ownership is not just you and me talking that there are hard statistics to back it up. Now Karen, here is the question I have asked all of my guests. I have been to nearly 300 employee-owned companies, many of whom are impassioned. Scot Forge has passion, you have passion for work, why do you think we do not see more employee ownership in America, and why do we not see more educators, thought leaders and politicians touting employee ownership?

Karen—From an insider's point of view, we are sort of smug. We know we have the best and we are not necessarily inclined to share it. From an outside point of view, if more managers knew how successful employee ownership can be within a company, there would be a lot more.

JMK—We met the enemy and it is us. So some of the fault lies with us—we know have this cool thing and we celebrate it, but we keep our light under the bushel. You are also right about the second point—we need a more effective vehicle to communicate this to managers. We are not trying to take anything away from them, we are only trying to give them something. Karen, before we close out, just a little plug for the Association, have you felt your membership has been beneficial?

Karen-Yes, absolutely. Just being able to mix with other enthusiastic employee owners is contagious.

JMK—No one should ever underestimate the power of being with others who share your passion and enthusiasm.

STATEMENT OF KAREN YORK, STAFF ACCOUNTANT, SCOT FORGE COMPANY, SPRING GROVE, ILLINOIS, ON BEHALF OF THE ESOP ASSOCIATION

Ms. YORK. Mr. Chairman, Members of this Committee, I thank you for this opportunity to speak for employee ownership and to share Dee's time here. I want to point out that I am not an executive at Scot Forge, where I work. I have been staff accountant there for the past 15 years.

Scot Forge is a 110-year-old company of 450 employees. We are a 100 percent employee owned S-corporation ESOP. In 1978, our owner transferred 20 percent of his stock to the employees. He believed the people who worked hard to make Scot Forge successful deserved to own a piece of the pie. Over time, our ESOP bought more stock, until we became 100 percent employee owned in 1997.

Is our ESOP providing a secure retirement system for our employees? I would ask you to look at some of the examples in my written testimony. I have several samples there of rank-and-file employees with account balances worth well over half-a-million dollars.

When we hear proposals that would force us to get rid of our Scot Forge stock, this really upsets us when we are looking at that kind of money. I am not just here to talk about the money side, though. There are two things at stake here, retirement savings policy and a better ownership policy. Ownership should not be the privilege of only a few in this nation.

So what does employee stock ownership mean to me, someone who represents the vast majority of working Americans? At the Forge, it means a great deal. It means that employees understand what our business is all about and how each of us doing our job tie into the whole. We believe good employee owners must partici-

pate in our democratic process in order to improve and expand opportunities for ownership. I would like to call particular attention to our open book management. Anyone who thinks employees are manipulated by management, I invite you, please come to Scot Forge and see how it works there.

You might ask, what if our company went under like Enron and then we would have nothing? Well, for one, we do have a 401(k) program that has no Scot Forge stock in it. But more important, I would rather live in a society where people like me can be owners of the companies where they work instead of just letting a few people at the top run the whole show. If employee ownership were more widespread, we would have a more democratic society and a more fair distribution of wealth. Scot Forge employees know that ownership means risk and hard work, but we also know the rewards it can bring.

As far as Scot Forge going under, we make real products that you can see and touch, products that are used in the basic manufacturing of our Nation. We all have a very real stake in the success of our company, and we know there are no guarantees, but I would put my future in Scot Forge any day, where I have some control, rather than place it with some mutual fund manager who has no connection to my world, who is buying companies I do not know anything about. After all, are not some of these financial experts the same people who were telling everyone that Enron stock was a good buy about a year ago? I will take my chances with Scot Forge. Thank you.

[The prepared statement of Ms. York follows:]

Statement of Karen York, Staff Accountant, Scot Forge Company, Spring Grove, Illinois, on behalf of the ESOP Association

Thank you Dee, and I am also honored to be given the opportunity to speak for employee ownership and ESOPs before the Ways and Means Committee. Let the record be clear, I am not one of the executives of the company where I work, Scot Forge. I am Karen York, a staff accountant in the accounting department of Scot Forge. Scot Forge is a 100% employee-owned ESOP S Corporation. We are a near 110-year-old company, of 450 employees. We began our ESOP in 1978, when our then owner transferred 20% of the company stock to our ESOP. He had inherited the company from his father, and instead of selling to a competitor, he thought the employees who helped make him well to do deserved a piece of the pie. Over time, our ESOP bought more and more stock until we became 100% in 1997.

If you wonder if our ESOP is providing a secure retirement system for our employees, I will quote some account balances for you: Lathe operator, $783,818; machine operator, $478.576; maintenance mechanic $881,073; forge shop supervisor $814,716; electrical engineer, $660,489; final inspector, $603,303; press operator $563,665; machine operator $597,207; and sales and customer service, $574.826. Attached to our testimony is more success stories collected by The ESOP Association in less than 24 hours. (Please see Exhibit 2).

I hope that these numbers will make you realize that when we hear that Congress, or the Administration, is saying that we employees at Scot Forge are dumb, and need to get rid of our Scot Forge stock, we in turn get pretty riled up, and get our employee owners involved with telling our representative in Congress to be careful.

But, I am not hear to just talk about the money side of employee stock ownership, because like Dee said, what is really before you are two policies—retirement savings policy, and a better ownership policy so that ownership is not the privilege of a few in this nation.

So, what does employee stock ownership through an ESOP mean to me, someone who represents the vast majority of Americans, who goes to work each day, puts in a good strong 8 hours, pulls in a paycheck, but who devotes much time and attention to my home and community?

At Scot Forge, it means a great deal. It means many employees understand what our business is all about. How we make money, how we might not make the money we had targeted in our budget, and why these results came about. We understand how each of us, doing our job, tie into the entire company, and how each of us should feel ownership, and most of all responsibility for what we do, and responsibility for our actions impacting our fellow owners.

As an attachment to my formal statement is the transcript of a radio show that I did as a guest last summer talking about Scot Forge and our ownership practices. (Please see Exhibit 3).

In the transcript I talk about open book management, our ESOP committee, our involvement with employee owners from other companies, and why we believe good employee owners must participate in our democratic process, in order to improve and expand the opportunities for ownership that each Scot Forge employee has. I call particular attention to our open book management, and say to any member of Congress who may say employees are manipulated by management because we are not educated, please come to Scot Forge.

I am more than happy to answer any of your questions, but before concluding, I know you might say, "Karen, you and your co-workers might have all of that money in the ESOP now, but what if Scot Forge went under, and then you would have nothing. Wouldn't that be a tragedy?"

Well, I can answer that question right now. One, I would point out that we have a 401(k) program at Scot Forge that we can participate in, and it has no Scot Forge stock in it. But most important, I would rather live in a society where people like me can be owners in the companies where they work, where people like me can participate in our ownership structure, instead of just letting a few of the top people take the risk of ownership. If employee ownership was more widespread, we have a more democratic society, and a society with equitable wealth distribution, not inequity.

You know many of us who work at our Spring Grove plant live in a rural setting. Many of the Scot Forge employees still live working the land, or raising cattle in our spare time. Many of us have been exposed to the risks of farming since childhood. We know that ownership means risk; we also know that it means hard work, and rewards.

As far as Scot Forge going under, well, we are not one of those go-go companies, or cyberspace companies. We make real products that we can see and touch, that are used in the basic manufacturing of our nation. We know that this does not guarantee continued success for Scot Forge; but I would rather put my future in Scot Forge instead of some far away mutual fund manager, who has no connection to my world, who is listening to advice to buy companies I have no knowledge of, and companies that really do not care about my community and my co-workers. I understand some of these financial experts who we are being told will take care of our money are the same people who kept telling everyone to buy Enron stock last year.

I'll take my chances with Scot Forge.

Again, thank you.

Chairman HOUGHTON. Thank you very much. Now, let us go to the questions. I would like to call on Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Ebright, do you believe that enhanced education of workers regarding investment choices is sufficient standing alone to safeguard against future Enrons?

Mr. EBRIGHT. Definitely not. The main reason is because it was not just the education of us, it was the education of anybody that had anything to do with Enron, from the Securities and Exchange Commission, the auditors, the people that turned around and said buy, buy, buy, the analysts. Those people must not have been very well educated because they were not doing their job to protect us.

If we had something reliable to listen to, a good company like the three companies that I have heard here today, we would not be sitting here talking about Enron and what happened. The problem is, the system failed to protect us, so we need more than just education to protect the people in the future because not all companies,

as we have seen, are honest, and especially the management to the employees.

Mr. COYNE. Do you have any thoughts on what changes in the pension law you would like to see enacted in order to protect the workers from experiencing what happened at Enron?

Mr. EBRIGHT. I think that there are a lot of other changes that need to be made first, but definitely, I do not think that anybody ought to be at the point where they have to hold on to a stock until you reach a certain age. By the time I was age 50, I already had 30 years in with the company. That is a long time to have to invest in one company. That is definitely something that needs to be changed. Some companies do not require that you keep it for any time period at all, and I see nothing wrong with that.

If you have got a good company—I was proud to own Portland General Electric stock. I was proud to own Enron stock for a while. But I think maybe there ought to be someone that does look at limits, because not all companies are good investments to make and maybe we do need limits. It might hurt some of these other companies down here that have these ESOPs, but Enron is not the only company that has gone belly up and a lot of people got hurt.

So maybe we need a 20 or 25 percent limit in there. I would not be opposed to seeing that, and if I had had that in our plan, I would not be here today in front of you.

Mr. COYNE. If that is the case, how much employer stock held by a single worker, an individual, do you think is acceptable?

Mr. EBRIGHT. Everyone that you talk to says that we ought to be diversified, and if anyone holds more than 20 or 25 percent of any one item, he is definitely not diversified. I am living proof of that. I had 60 percent of my 401(k) in my employer, and because he turned out to be a fraud, it was definitely not the thing to do.

Mr. COYNE. You touched a little bit on the lockdown period. What changes would you like to see with respect to plans going into those lockdown periods?

Mr. EBRIGHT. Definitely, if we are going to go into one, and I know that at times they have to take place, there ought to be good information that is sent out, not just e-mails to employees. Not all of the PGE employees have e-mail. So, consequently, there ought to be sufficient and adequate correct information about which days the plan is going to shut down.

It ought to be limited as to how long it can be shut down because it does not take forever. In our case, I could not get in 2 or 3 days before the shutdown. Human Resources could not get me in before the shutdown. And it is systems like that that fail. We need laws that are going to make this work. If there is going to be a shutdown, make sure everybody knows exactly when it is going to be, how long it is going to be, and that we are protected that those things will happen.

Mr. COYNE. Thank you.

Chairman HOUGHTON. Thank you very much.

Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman.

Mr. Trumka, I would like to ask you if you feel that there was pressure to buy stock by the Enron company. You said there was and you do not believe there should be.

Mr. TRUMKA. I think there was definitely exceptional pressure exerted on the Enron employees to continue to buy Enron stock.

Mr. JOHNSON. Is that true, Mr. Ebright?

Mr. TRUMKA. It was given by——

Mr. JOHNSON. Let me ask them. Is that true? Did they force you to buy that stock, or pressure you?

Mr. EBRIGHT. No, sir, they did not force us, but they sure tried to get us to invest in the company, yes, sir.

Mr. JOHNSON. How did they do that?

Mr. EBRIGHT. E-mails, different things that we saw coming about how great the company was. When it really got bad, it was the e-mails that said that it is undervalued and you had better hang on, better get in there because it is coming back up.

Mr. JOHNSON. You read the e-mails when they say that, but they e-mailed you when the blackout period was going to begin and they also e-mailed you 30 days' notice on that blackout period.

Mr. EBRIGHT. Yes, they e-mailed me——

Mr. JOHNSON. Did you see that?

Mr. EBRIGHT. On the notice of the blackout period, yes, sir, but they also kept me from getting in before the date of that blackout period came.

Mr. JOHNSON. And what date did you think that was going to start?

Mr. EBRIGHT. I do not have that date with me now. I am sorry, sir.

Mr. JOHNSON. Okay. As far as the unions are concerned, Mr. Trumka, you believe in protecting the rights of individual workers, I think. Do you think that your union Members ought to have the choice to convert union pension contributions into individual property after a period of employment, where trustees would manage the funds individually?

Mr. TRUMKA. Sir, I did not hear the last part of the question.

Mr. JOHNSON. Do you think that union Members ought to be given the choice to convert their union pension contributions into individual property after a certain period of employment or where trustees would manage it?

Mr. TRUMKA. I really do not understand the——

Mr. JOHNSON. Can they buy stock with their union funds? Do you not think——

Mr. TRUMKA. With their union funds?

Mr. JOHNSON. In your retirement system, I think Federal Government employees, how are they in a union allowed to prepare for retirement? What are their pension privileges?

Mr. TRUMKA. Our position is this. First of all, you have a three-layered pyramid. The bottom layer would be Social Security, with its guaranteed benefits.

Mr. JOHNSON. Yes, you said that.

Mr. TRUMKA. The second layer would be a guaranteed defined benefit plan so that those benefits were guaranteed. And then on the top of that would be workers' savings, which would include tax-favored 401(k)s that we are talking about here. In that 401(k), they have the ability to manage those assets. They also do not have—we do not encourage them to put all of their assets in one company

if that is their only savings plan because you end up with people not prepared for retirement because of a collapse.

Mr. JOHNSON. Are your union pension plans protected?

Mr. TRUMKA. The defined benefit plans are protected, yes.

Mr. JOHNSON. But do you have 401(k) options, as well?

Mr. TRUMKA. We have those on top of defined benefit plans so that a worker—yes, we encourage a worker to get a defined benefit plan so that the benefit is guaranteed, and then they get a 401(k) as a supplement. We have those, as well.

Mr. JOHNSON. And how do you protect those supplemental 401(k)s for your own union Members?

Mr. TRUMKA. Well, they are protected like everybody else is, but their retirement security is protected because they have a guaranteed benefit plan so that even if the 401(k) plan happens like it did to Enron, they are still protected. In fact, we had Members that worked at Enron who are no worse off today retirement-wise than they were before the bankruptcy because they had a defined benefit plan.

Mr. JOHNSON. Under our information, Enron also had a defined benefit plan, they had an ESOP, and they had a 401(k). Were those available, all of them, to you, Mr. Ebright?

Mr. EBRIGHT. No. I was not available to have the ESOP plan. I was available to have the 401(k) and the defined benefit plan.

Mr. JOHNSON. So you could have had them both?

Mr. EBRIGHT. Yes, but my defined benefit plan got converted to a cash balance, I guess you could say, cashed out. It was something that was negotiated in 1998, if I am correct, and we cashed out of that defined benefit plan so that we can turn around and receive more company stock, a higher percentage from them in our 401(k).

Mr. JOHNSON. Was that voluntary or did they ask you to do that?

Mr. EBRIGHT. It was voluntary if we wanted to be able to cash out of the defined benefit plan instead of taking the annuity.

Mr. JOHNSON. Okay. And did you realize at the time that that was going to cost you a defined benefit, so to speak?

Mr. EBRIGHT. At the time, no, and the reason was, as I have got in my testimony, at that time, I had approximately $730,000 in there and when I opted to sign out of the defined benefit plan, which might have given me about $2,000 a month, it gave me $200,000 to add to my 401(k), which looked like a good sum that would tide me over until the day that I could draw Social Security.

Mr. JOHNSON. Did you ever have any investment advice?

Mr. EBRIGHT. From who?

Mr. JOHNSON. Anybody.

Mr. EBRIGHT. Yes, I have talked to different people. I never went out and paid anyone for investment advice, but I talked to different people. A lot of them told me that I invested too much in one thing, and I have to agree with them.

Mr. JOHNSON. Yes. Mr. Chairman, may I ask one more question?

Chairman HOUGHTON. Yes.

Mr. JOHNSON. I would like to ask Mr. Trumka one more, if I may. Your funds are protected, and yet the most recent Department of Labor Inspector General's report to Congress paints a little

bit troubling picture, saying the union pension funds are vulnerable. The Inspector General says, and I quote, "Investigations continue to identify complex financial and investment schemes used to defraud pension assets, resulting in millions of dollars of losses to plan participants." The report goes on to say that these pension plans, which control hundreds of billions of dollars in assets, are vulnerable to corrupt—they use that term—union officials and organized crime influence. The report includes numerous examples of fraud and kickback schemes, and this is happening on your watch. Would you like to comment on that?

Mr. TRUMKA. Yes, I sure would. Those pension plans that you talk about are jointly managed between union workers or employees and management trustees. That is a law that you set up. In addition to that, those pension plans are guaranteed by the Pension Benefit Guaranty Corporation So if they go down for any reason, bad investments, the benefits to those employees are protected and guaranteed. The other thing I would say——

Mr. JOHNSON. But if there is a——

Mr. TRUMKA. There is also ample laws——

Mr. JOHNSON. Just a minute——

Mr. TRUMKA. To protect those beneficiaries from any kind of fraud, and I would urge you, I would urge you, if you find that fraud in pension plans, pursue it, because workers deserve better.

Mr. JOHNSON. I would like to pursue that and we may try to do that. However, I understand that one time you took the Fifth under investigation of some of these fraudulent acts. Is that true?

Mr. TRUMKA. That is just totally inaccurate, Mr. Chairman. I was never under any investigation related to any pension plan.

Mr. JOHNSON. Okay. Thank you, Mr. Chairman.

Chairman HOUGHTON. Mr. Rangel.

Mr. TRUMKA. And furthermore, I might add—never mind. I guess that probably you have taken a few Fifths yourself.

Mr. RANGEL. Well, now, I can see why the Chairman did not want the full Committee to get involved in looking at this subject matter.

You know, Mr. Chairman, you should be congratulated for having this hearing because it really shows the interest of the Members where instead of being outraged that hardworking people can be ripped off by irresponsible criminal acting executives, it would seem to me that the Committee of jurisdiction, the Full Committee of jurisdiction, should be outraged. I almost feel that we are a party, not to the Enron scandal, but the vulnerability of all of the people that are listening to this testimony that feel insecure because they are invested in 401(k)s at the encouragement of this Committee. We provided the tax incentives.

And this Committee would have us to believe that we should try the same thing with Social Security, or at least the leadership of this Committee, and I can hear it now when people who are depending on the Social Security benefits, did your kids not tell you that this was the free market system? Did you not have somebody to advise you as to what you were doing? Did anyone force you, I mean, force you to invest in the public sector? Was it not greed that motivated you for a higher yield when you went into this?

And the very same people that the President appointed to suggest to us that we should give the people an opportunity to work their free will and go into privatization says, but do not dare do it in an election year because you will get killed. Well, I guess they are right. This is an election year, and this Committee has seen fit not to bring this issue in front of the full Committee.

Let me thank you for taking the time to come to appear before this Committee. I guarantee you that we may not be able to do a lot in making you whole for trusting your Congress, your tax laws, your employers, and I hope that we are able to make you whole. I think we do have some kind of responsibility. But at least the rest of the people should know that we have a responsibility not only of enacting the laws, but providing oversight for the laws.

And if you had to scrutinize the backgrounds of Members of Congress the same way you are suggesting that you scrutinize the people you depend upon, who are your employers, I do not know how many Members of Congress could stand that test. No, you are supposed to have confidence in your Congress and confidence in your employers and not to believe that they would rip you off and at the same time benefit themselves.

And if we lose that at Enron or any other company, then we have lost it in America because we are a capitalistic society. We have to learn to trust each other. But we lose that trust if we refuse to bring these issues and hear them publicly.

I am glad, Chairman Houghton, that you provided the leadership for this Subcommittee. I encourage our Chairman to do the same thing, not to be vindictive, but at least to improve the law so that this does not happen again. I thank the Members who have seen fit to come and to join in these hearings, but most importantly, the witnesses. Some of us in the Congress feel an obligation not to let you down further. Thank you for taking the time out and sharing your experiences with us and in hoping that we do not make the same mistakes again and repair those areas in the law that allow these types of things to happen. Thank you very much.

Chairman HOUGHTON. Thank you, Mr. Rangel. Mr. Foley?

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

I want to make certain everyone knows that I am outraged by the conduct of Enron. I think the executives, without question, who participated in this financial chicanery need to be brought to justice. My earlier comments were of a concern of changing the entire playingfield because of a set of bad actors.

There is no question we have got to find an answer to some of these complex questions, and I think the full Committee should be part of it. I would welcome any Committee in this Congress to assemble 24 hours a day to bring those very people who stole your life savings to justice. This is theft. This is fraud. It is collusion. It is disgusting. It is despicable, and it is heinous.

There are a lot of employees, though, that I know that I have talked to, and the reason I brought up the subject of another body across the hall and a particular piece of legislation sponsored by that Member is because some people would have us change the laws because of one set of circumstances. I want to first get the facts and make certain that it deserves that kind of change before

we limit employees who may be working for successful companies, keeping them from having a chance.

I mean, Enron for years, I am sure, was a great company, whatever it was called before it was Enron, and there are a lot of people who gave 30, 40 years of hard sweat and labor and loved their company, and all of a sudden, a couple people got brought into the corporate suite that saw it as a personal cookie jar and raided and ripped off, with the help of others watching over the books, or at least were deceived by what were in the books. So I think that is something that has to be investigated fully.

Dee, who is a friend, and I appreciate having spoken to ESOP groups before, they are somewhat cautious. I think their testimony today indicates that they do not want to be swept under the rug because of a couple of bad apples. The financial aftershock of Enron has caused a lot of companies problems. Dee, explain just a bit about the ESOP, why you feel if we do a sweeping reform, what may happen to companies like yours.

Ms. THOMAS. Thank you, Congressman Foley. Our biggest concern is the diversification issue. We are a small company and we already have a diversification rule, the 55–10. It is working even in a small company our size. And if that suddenly becomes more drastic, if we drop down to five or age 35, those types of numbers are frightening and, frankly, I doubt very seriously that our ESOP would be able to survive those types of changes.

So when we look at what at least the different bills that have surfaced, certainly not only Ewing & Thomas but my friends at Scot Forge and other ESOP companies across the United States, our largest concern, I think at this point, is the diversification issues, especially as they affect the private companies.

Mr. FOLEY. Thank you. Mr. Trumka, regarding an article that appeared in Engineering News, Union Labor Life Insurance Company (ULLIC), which is, of course, a pension fund, invested millions of dollars in Global Crossing stock, and obviously Global Crossing seems to be a similar sad story as Enron. As a result of the failure, ULLICO's financial misfortunes, the pensions of 13 million AFL–CIO workers may be affected by the fall.

The troubling thing is Michael Arsteed, who was Senior Vice President of the Union Life pension fund, invested $7.5 million along with Mr. Winnick of pension dollars with the expectation that the unions would then get the work. Do you consider that an arm's length transaction, using fiduciary deposits by pension Members investing in a company and then expecting or at least counting on work being provided to union shops for that exchange of dollar?

Mr. TRUMKA. The union pension money is invested in all sorts of things, and one of the objects is to try to get work for its Members, to try to improve the community within which they do business. Now, I am not familiar with the Global Crossing. ULLICO is not part of the AFL–CIO. It is an independent company.

But there are all kinds of funds, State funds, pension funds, that invest in opportunities to create work for our Members. We just invested in housing in New Orleans to help, one, clear up a blight area, to create low—and middle-income housing, provide job opportunities for people who live there, to put them in our apprentice-

ship program, and then create work for our trades people that were in the various trades that did the work. I think that is a very appropriate investment. I am not familiar with Global Crossing, though.

Mr. FOLEY. I guess it seems that so many companies, you know, Enron and others, that you can get caught in these things, because you do not do it intentionally. You do not obviously risk your pension Members' investments. If you get face material and a prospectus and you look at their business plan and you know the Internet is going to need wiring, anybody looking at Global Crossing would assume this cannot fail. It is like stringing telephone lines. The more customers, the more income.

Mr. TRUMKA. Enron and Global Crossing and Lucent, there are a raft of them. For 3 years, we have been saying that it is the system. It is not just Enron, it is the system.

First, there were conflicts of interest with the board of directors. Directors that were supposed to be independent were not independent. They became partners in special purpose entities. They had business dealings on the side. They let things slip.

Then there were accountants, accountants that were supposed to be independent. They were not independent. They began making more money with consulting fees than they did with the auditing fees that was there.

And then you had the analysts that were supposed to be independent, and you had, after Glass-Stenholm expired, you had them loaning large sums of money to companies like Enron while at the same time saying to the general public, we are an independent analyst. Buy. Strong buy.

Those conflicts are what caused Enron to collapse. They exist in a multitude of places. I do not know if they existed in other companies. I do not know if they existed at Global Crossing or not. I do not know if they existed at Lucent. I do not know if they existed at four or five other companies that happened. But the system needs repair.

I applaud you for saying you want to get the facts and fix it, because that is what this ought to be about instead of cheap political shots here. I am really saddened that at least one of your colleagues thinks so little of the people like this person and the millions of workers out there that have their 401(k)s at risk, that instead of looking at this thing and trying to fix it, he tries to score political points. That is a sad thing. It is a sad tragedy for this Committee if the Chairman allows that type of thing to occur. This is a serious problem that affects millions of workers potentially, and as I said at the beginning, we stand ready, willing, and able to help you fix the problems that are there.

Chairman HOUGHTON. Thanks very much.

Mr. JOHNSON. Mr. Chairman, may I respond to that?

Chairman HOUGHTON. Sure.

Mr. JOHNSON. I think you mislabeled me. I have a serious concern for the employees of Enron, and we are trying to get to the bottom of it and fix it. The problem is, you know, you, I think, have protected the union. You said you did not know anything about Global Crossing, but the union AFL–CIO pension fund, which you

may not be directly associated with, invested $7.6 million in Global Crossing. You said you knew nothing about it.

Mr. TRUMKA. The question is, so what? You invested in Enron.

Mr. JOHNSON. I did not. It is a failed company. It is like Enron. So how do we fix it?

Mr. TRUMKA. First of all, your statement is inaccurate. We never invested in Global Crossing. Check your facts.

Second of all, you know, pension funds that I am not a trustee of make investments across the board, a lot of them. Some of them are good and some of them are bad, and we try to minimize the ones that are bad. We work with management trustees on all of our funds to try to create a strong secure retirement for our Members. There is no plus in having more people like these employees right here come up to retirement age and have their whole nest egg fall apart.

For 3 years we have been saying that. We are not Johnny-come-latelys to this issue. For 3 years, we have been trying to get an open year. For 3 years, we have been trying to get a Committee that would look at the conflict of interest that exists in place after place after place. Now, unfortunately, Enron happened and people are starting to take a look at it.

But do not believe that Enron is the only one out there, because honest companies fail, too, and if you have invested everything you have in an honest company and it fails, you are in the same miserable position as you are with a dishonest company that failed.

Mr. JOHNSON. I agree with you, and that is why the law needs to be fixed, tweaked, if you will. Thank you, Mr. Chairman.

Chairman HOUGHTON. Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman.

Dee and Karen, it is my understanding from your testimony and looking at some of the pieces of legislation that have been introduced, so far, except for the exception of one or two, basically, you have been carved out. So then my guess is that the assumption is that you are happy with where we are headed in some of these proposals.

Ms. YORK. Mrs. Thurman, actually, when you work in a successful ESOP company like Dee and I do, I think we would be most happy if you left the law alone. We think it is working just fine the way it is for honest companies——

Mrs. THURMAN. For ESOPs.

Ms. YORK. And for ESOPs, yes, for ESOPs. In my company, I do not put a penny into that stock. That is contributed by the company. None of that comes out of my pocket. So if I have a half-a-million dollars today and nothing tomorrow, well, I had nothing yesterday before I started there. It is not my money that is being invested there.

Mrs. THURMAN. And I think that really is a very important point, and that is what Mary and some other folks told me, that they had $60,000. She is 32 years old and for the first time, she feels like she has something, but the money did not come from her pocket. She goes home, she gets a paycheck, and whatever their profit is is what gets put back into the company for the return.

Ms. THOMAS. That is true, and Congresswoman Thurman, let me also add that because of that statement is a fact that if the

company has to abide by more mandates, by more quarterly reports, by increasing or changing the diversification pattern, if more of those types of mandates are given to companies like Karen and mine, then the money that that 32-year-old Mary is going to have at the end of the year clearly is not going to be as much because these are employer contributions. So I think that is a good point.

Mrs. THURMAN. Let me go over here and say to the both of you from Enron that we are very sympathetic to what is happening and cannot even imagine what it must feel like today. Actually, Mr. Ebright, I was reading your testimony and found it interesting, and I do not know how and what we do on this, but if you looked at, first of all, what your stock would have been valued at in September, I guess it was about $403,000, and in your statement, you said in late September you kept trying to get hold of these people so that you could make a decision to get out. You were actually looking at getting out because you were seeing, and this was before the lockout period, is that my understanding?

Mr. EBRIGHT. Yes, that is correct. It was a couple of days before. I kept looking at it and not knowing whether or not the company was going to survive and looking at what percentage I had in there. I had made a decision, talked it over with the wife, and decided that I was going to move part of my Enron money, but I was not allowed to.

Mrs. THURMAN. But the fact of the matter is, you would have saved yourself over $300,000—and some at that point.

Mr. EBRIGHT. You bet.

Mrs. THURMAN. And only because you were put on hold, you were told that you could not get hold of anybody, call back, and at the same time, were you trying to work? What were the hours of that office?

Mr. EBRIGHT. Well, see, what I tried to do is at home on the Internet, log into the site. I could log into the site, and I could do everything except for transfer money out of Enron stock. So I got hold of the business manager at the union, told him what was going on. He gets hold of Human Resources. Human Resources calls me and says, go home and try it the next day.

Mrs. THURMAN. They kept putting you off.

Mr. EBRIGHT. I go home and try it the next day, and it does not work. It was an ongoing problem.

Mrs. THURMAN. It would seem to me, Mr. Chairman, with having the computer there and having the ability to go back and check, certainly there has got to be some ramifications when somebody wants to do the right thing. We have said they need to have the ability to be able to look and make changes in their stock and have that right, that there should be some way to go back in and look where those transactions would have been made that would have put some legal, and I do not know what the legal issues would have been on that, but certainly something that I think we should look at.

Before I run out of time, Mr. Trumka, let me ask you something, because there has been a lot of conversation today about this bill that was passed off of the House floor a couple weeks ago, the investment advice bill. It is my understanding that people seem real pleased with that. Now, I have to tell you, I did not vote for that

because I thought we were taking away some things for people at this time that were in the law, that actually we could have had advisors that would have been paid for. Maybe you can explain to me where the problems were with that and if you see that that would have been able to tighten some of this down instead of doing what we did.

Mr. TRUMKA. To put the person or the money manager in charge that is investing the funds creates yet another conflict of interest. They have every incentive to advise and steer beneficiaries to their high-fee, high-turnover investment vehicles.

We think that the present prevention of that, the law that currently prevents that, should continue, that the fund should pay for independent advice separate from those that supply the investment vehicles and treat that as any other cost of managing money, so that it does not go to the beneficiaries but that it is paid for by the fund itself and becomes a part of managing—a cost of managing money.

Mrs. THURMAN. Could that have helped these Enron employees, if they had been able, instead of just getting the information from the company——

Mr. TRUMKA. That alone will not solve the problem.

Mrs. THURMAN. Not alone, but would it have been helpful?

Mr. TRUMKA. Of course, it would have been helpful.

Mrs. THURMAN. Okay.

Mr. TRUMKA. It would have been helpful to have independent investment advice, but it would not solve the problem because of all the other conflicts that were there and all the other structural failures within the system. None of the safeguards that should have been there for these employees and others like them were in place.

Again, the directors were not independent. The auditors were not independent. The analysts were not independent. They were all conflicted, and so bad information came out. And you had other activities. I think there was probably active concealment of various aspects of Enron's business. Those facts will all come out at some other point, and I do not feel very qualified to talk about all of those.

Mrs. THURMAN. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thanks very much. Mr. Pomeroy?

Mr. POMEROY. Thank you, Mr. Chairman.

Let me begin by expressing my profound sorrow for the loss of your retirement funds in your 401(k) plans. We are learning a lot from the tragic demise of income you had counted on for a secure retirement. I hope while we figure out the long-term consequences, we can also address in ways directly relevant to your needs going forward how we deal with this. I do not have any ideas right now.

One thing that does occur to me, and I think that we have got to look at very carefully, as we look at what happened to your 401(k) is that thank goodness you have got Social Security there undergirding it, because as you look at what has happened in terms of the risk people now have with their 401(k), and there is all kinds of risk.

First of all, there is risk you may not even have at-work retirement savings. Half the workers do not, so that is a big risk. Then

if you have got a plan, you probably have a 401(k) plan, not a defined benefit plan, a 401(k) plan and hopefully you are going to be able to save enough money in there, but you have got to risk maybe you will not be able to save enough money. Then you have got a risk that you are going to invest that in a way that gives you the kind of return you were hoping, and that is a risk for a lot of people.

You get all these risks, and then when you finally retire, you have got a nest egg. You do not know how long you are going to live. You have to risk, you are going to miss it, and you are going to take all your money and spend it while you are still alive and you are going to be old and broke and sick, so that is a risk.

Now, fortunately, Social Security offsets that risk a little with a guaranteed payment every month that you cannot outlive. I do not know if you care to comment or not about the importance of at least having that as a backstop. It is not going to do it for you. It is not going to get you where you want to go, but at least it is a backstop and fundamental retirement income. A comment, Ms. Perrotta?

Ms. PERROTTA. In my testimony, I did mention about that——

Mr. POMEROY. I saw that.

Ms. PERROTTA. That it is very important that we have the Social Security to back us up, especially right now. There are people that need that right now.

But I also want to bring back to our situation as far as if we had defined benefits. I am not aware of any defined benefits at Enron at all. All I know is we had the 401(k) and we had some other options. I did not invest 100 percent into Enron. I diversified, which saved me. But also, Enron had a cash balance plan, that they put in 5 percent of your yearly salary every year, but that was not eligible until after you were 5 years. So there was nothing that I could have gotten out of anything.

As far as the Social Security, right now, it is important to keep it where it is.

Mr. POMEROY. I think we have got to understand the point you make so well in your testimony and your answer. We have got a lot of risk out there. Let us look at Social Security as someplace where you offset that risk with a very secure retirement program. To the extent you can, in addition, have defined benefit pension plans that also pay every month during retirement, so much the better. So let us really be attentive to keeping defined benefit plans out there to the extent we can. If we can refurbish them and make them more attractive, let us do that, too.

Ms. PERROTTA. Yes, correct.

Mr. POMEROY. As we look at what we can do in terms of 401(k) specifically and making them more secure, safer, letting people diversify earlier, Mr. Ursprung, your testimony was quite interesting on that point. Right now, there basically is a tax incentive for employers to contribute stock in their match. They get to deduct the fair market value but it is not reflected on a liability. It is almost a free match. I like the fact that they are matching because it is going to mean the employee is saving more and enjoying an account accrual later, and yet it seems to me that they are going to need to diversify.

The Administration has proposed a 3-year time length and after that you could diversify, that you cannot restrict it beyond 3 years. The Enron plan, for example, if you were under 50, you could not diversify. Do you have a sense as a businessowner whether the 3-year would be adequate? Could you live with a shorter one? Is this the way to go?

Mr. URSPRUNG. The experience in our company led us to loosen the 55 and 10 diversification. We happen to be a profitable company with a strong balance sheet and strong cash flow, and we have been able to do that within the affordability of the company and allow people to diversify out of the ESOP and into the 401(k) before age 55.

For many, many companies, I think the 55 and 10 regulation is adequate or more than adequate. I do not hear a lot of complaints about it.

Mr. POMEROY. That is on the ESOP.

Mr. URSPRUNG. Yes.

Mr. POMEROY. Right. On a 401(k), I mean, we are quite interested in letting——

Mr. URSPRUNG. Our 401(k) contributions are made in cash. The company contributions are made in cash and employees can invest in whatever funds are available. I think that there is merit to considering, if those contributions are made in company stock, that the employees ought to have some option to diversify earlier than age 55.

Mr. POMEROY. Thank you. One final question, Mr. Chairman——

Mr. URSPRUNG. Just on something you said earlier——

Mr. POMEROY. Yes?

Mr. URSPRUNG. The Committee may not want to hear this, but to be perfectly honest with you, I believe if you surveyed the 400 people in our company, they would rank, in terms of trust and security and their future, they would rank ESOP one, they would rank their 401(k) two, and they would rank Social Security a distant third.

Mr. POMEROY. I think the Enron employees would rank the reverse order, with Social Security being first. It just depends. Three years ago, we forgot about downside risk, and it was all up, up, up. Of course, life is not like that. Life has loads of risk and the way you manage risk is offsetting risk with security. You deal with both. You have risk and security.

Mr. URSPRUNG. And it is not a near-term threat to employee ownership that brought me down to Washington today. It is not. It is a broader threat to ownership and entrepreneurship in America that brought me down here today and my concern that if we do not do things in an enlightened way, it is going to have a detrimental effect on our ability to compete in the world.

Mr. POMEROY. You have been a very good corporate citizen and done well by your employees with those benefit packages, so your counsel in that regard is something we have to listen to very closely.

One final point, Mr. Chairman, just to clarify something that is out there, Mr. Trumka, it seems to me as though an insinuation was made that, somehow at AFL–CIO, you are looking at union

managed pension plans in ways that would depart from your fiduciary responsibility to those employees who have their retirements represented by those funds. Have you ever, or has AFL–CIO ever proposed departing from the strict fiduciary standard that you owe those future retirees?

Mr. TRUMKA. Absolutely not. In fact, we offer courses to new and existing trustees on fiduciary duty. We offer them online so that they are available to more people. We encourage and help them to take the courses. Everything that we have tried to do with our pension plan is to amplify the security for the workers whose deferred wages it represents.

Mr. POMEROY. Thank you.

Chairman HOUGHTON. Thanks very much.

I would just like to say a few words at the end. I would like to try to tie this thing together a little bit, because as I mentioned earlier, the problems raised by Enron are a wake-up call but they should not be totally compulsive to this discussion. Naturally, we are terribly disappointed and shocked and saddened by the thing that happened to your particular pension security. But the question really is on retirement security and what is wrong with the system and what is wrong with the people.

I was listening to you, Mr. Ebright, originally, and you really could have sold your stock before the amalgamation took place, before the company was stock. And then, also, you had 4 years to sell that stock and that was your own decision. So the question was, was the system wrong or was it just the management that was totally a fraud?

So those are the things I think we are going to have to separate. Maybe any of you would like to make some comments at the end here.

Mr. EBRIGHT. Yes, I would like to comment on that. Yes, I had 4 years that I could have sold some of my Enron stock before that took place, but that is where the system really did let me down. It has been mentioned here quite a few times that the analysts were crooked, the auditors were crooked, the management of the company that was telling us how great it was and how well it was doing was crooked. I do not know why the Securities and Exchange Commission did not know that this company was pulling the wool over everyone's eyes.

The whole system was letting me, the employee, me, the investor, down because I was reading and hearing false information. And because of that, yes, I did not sell-

Chairman HOUGHTON. Can I interrupt just a minute? Was it the system or was it the people, because you have other situations in other companies where the thing has just gone along like clockwork, but you had people you could trust. In this particular case, you did not. How do you legislate trust? How do you change something?

Mr. EBRIGHT. I do not have an answer for that and I do not think anyone does. I did trust Portland General Electric, the company that got bought by Enron. I trusted them, and then when Enron kept telling them things, they passed the information along to us, and we had no choice but to believe it. Somewhere, there is a big failure in not only the people that pulled the wool over our

eyes, that duped us, but also in the system not being able to see that that was taking place.

We do not have the expertise that a lot of people are supposed to have to be able to analyze these financial cheats and everything. So, consequently, we have got to rely sometimes on a star sitting there saying that this analyst said buy or not buy or hold, and the system—Enron created a great injustice to our whole financial system because the economy has completely taken a tailspin. Because of what Enron had take place there, people are not trusting the system in general throughout the whole country, and I know it because I have had other people tell me the same thing.

Chairman HOUGHTON. I would agree with you that it is a shocking performance. Having been in business for 35 years myself, I identify totally with what you are saying. But the question really here is what do we do about this, because so much of it relies on the individual capability and the trust of the people who are running the shop. So how do we do something to the system, and there will be changes made, that does not totally warp it and ruin the other opportunities that are out there for the entrepreneurial spirit, as you were talking about earlier?

Did you want to say something, Ms. Perrotta?

Ms. PERROTTA. Yes, I did. I would like to say something to that effect. I am not well versed in the pension policy. I am just one of the little people. What I am hearing is, again, protecting the big corporations and I feel that us, as employees, the corporations, they duped us. What was good for the goose should be good for the gander, but at Enron, the gander got rich and we got our goose cooked, basically, and they were protected by this Committee and this government. We were not protected.

And I feel that there should be some overseeing and there should be some changes in the pension plan. If you want to invest in your company stock, that is up to you, but do not make that the mandatory way you can make money.

Chairman HOUGHTON. But I guess the question I have is, let us say there are all the changes that you think ought to be made in the pension system. Then what protects you from joining another company, that you believe in the management and they do the same thing to you they did to Mr. Ebright? What protection have you got?

Ms. PERROTTA. You had to be around the Enron environment. I mean, they were the seventh largest company in the United States. I am going to repeat myself on this, I realize that. But the analysts, we had government officials, you have the management, everybody was saying how fantastic the company was doing and the people were making money. Yes, it was a chance for us to increase our savings, and we were convinced this was the best buy. All over the country, people thought this was the best buy. So we put a lot of faith into that company, but there was no policy in place to oversee what was going on. Somebody should have seen something. And I think by having——

Chairman HOUGHTON. Tell me who that somebody would be.

Ms. PERROTTA. It could have been the accounting firm. It could have been the analysts, really. I think they should have seen something, but they did not.

Chairman HOUGHTON. Do you have any comment——

Ms. YORK. Mr. Chairman.

Mr. URSPRUNG. Mr. Chairman, in 1986, Congress passed the Tax Reform Act 1986 and some problems started then, perhaps before then. I think you will understand from your career at Corning that it is important for the interests of top executives and the interests of employees to be in alignment. It is important to align the interests not only of top executives and employees but of outside shareholders in the company. The closer you can get that alignment, the more energy-filled, the more powerful, the more competitive your organization can be.

We have a trend in the United States, and Enron is only one example, of divergence in this area of pension. Today's *New York Times,* on the front page of the business section, has a very enlightening article, and it is not about the Enrons and Global Crossings, it is about GE and Tenneco and IBM and what the boards have allowed the executives to do in diverging their interests from the employee interests and that is un-American, sir. It talks about the fact that top executives at GE can get a guaranteed 10 percent return on their contributions to the pension fund and employees cannot. That is not right.

[The *New York Times* article follows:]

New York Times
March 5, 2002

For Executives, Nest Egg Is Wrapped in a Security Blanket
By DAVID LEONHARDT

General Electric (news/quote) allows its top executives to contribute money to a retirement fund on which the company recently guaranteed an annual return of at least 10 percent, far better than a typical G.E. worker saving money in the company's 401 (k) plan can expect.

Tenneco Automotive (news/quote), which makes shock absorbers, permits its executives to receive a full pension at age 55, 7 years before the company's other employees can.

When Louis V. Gerstner retired as I.B.M.'s chief executive last week; he became eligible for an annual pension of at least $1.1 million, precisely what the company promised in his contract when he joined 8 years ago. As part of a 1999 cost-cutting program, however, many I.B.M. (news/quote) employees are set to receive smaller pensions and retirement health insurance benefits than they were promised when they were hired.

Such contrasts have become the norm over the last two decades, as the United States has increasingly developed a two—tier pension system. Companies seeking to increase profits have cut retirement benefits, leaving many Members of the baby boom generation unprepared for life after age 65 despite the long bull market, economists say.

But executives have persuaded their directors to reward them with everlarger pay packages. On top of millions in salary, bonus and stock options, many top managers have received pensions that are more generous than they once were and are often devoid of the risk inherent in the typical 401 (k) plans that have replaced the old company pension for many workers.

Some companies give their executives large annual payments and guaranteed investment returns. Others, including Bank of America (news/quote) and Esté Lauder, pay the premiums on life insurance policies for executives, allowing them, or their heirs, to collect cash payments decades after retirement. Delta Air Lines (news/quote) and the AMR Corporation (news/quote), the parent of American Airlines, as well as other companies give executives credit for many more years of service than they actually have, increasing their pensions.

In recent weeks, policy makers have focused attention on the plight of workers at Enron (news/quote) and Global Crossing, who had invested most of their retirement savings in company stock that is now almost worthless. Many executives escaped in much better shape, having received multimillion-dollar payments or sold

many shares before the companies filed for bankruptcy and their share prices plummeted.

Far more common, however, are the diverging of fortunes at healthy companies like G.E. and I.B.M. From 1983 to 1998, the last year for which the government has published data, the amount of retirement money held by the typical household with people from age 47 to 64 fell 11 percent after being adjusted for inflation, according to a recent study by Prof. Edward N. Wolff, an economist at New York University. That number includes private pensions and the value of anticipated Social Security benefits.

The decline occurred as many companies replaced traditional pensions, which pay a predetermined annual benefit with voluntary savings programs like the 401(k). While higher-income workers were able to save a significant part of their salaries and benefit from the stock market's run-up, many other workers found it hard to set aside money for retirement. At the same time, companies were cutting their retirement contributions as they switched to 401 (k) programs. Expected Social Security benefits have also declined since the early eighties because inflation-adjusted earnings have fallen for most workers.

"A lot of families are going to have to work more years to buildup their pension accounts and generate enough income for retirement," Professor Wolff said. "It's basically a decrease in living standards."

Executives, meanwhile, have sweetened their pensions, ensuring that the plans will be generous even if the company's stock, or the market as a whole, is suffering, pay consultants say.

Judith Fischer, managing director of Executive Compensation Advisory Services, said, "In the early 90's, when risk reared it ugly head" and a recession brought down many share prices, "executives went back to their companies and said 'Look, let's add a little something extra to abate the risk."'

As a result, Ms. Fischer added, "Executive retirement plans and employee retirement plans are really no longer recognizable as related."

There are no broad statistics on executive retirement programs, in part because companies are not required to publish many of the details. While companies must report the salary, bonus and stock award for each of the top five executives, they can lump together pension liabilities without specifying how much is owed to, executives and how much is owed to other employees.

The boom in executive pensions began in the eighties, after the Federal Government enacted a law limiting the amount of an employee's salary that a company can consider when contributing to pension coffers. Executives quickly flipped the purpose of the law by establishing separate retirement plans for themselves, divorcing their financial interests from company pensions.

In many cases, executive pensions give benefits that are far more generous than rank-and-file workers receive, even after the differences in salaries are taken into account. Bank One (news/quote) adopted a plan in 1998 that pays top executives up to 60 percent of the average of the final five years of their salary, according to a company filing with the Securities and Exchange Commission.

Tenneco, in calculating pensions, multiplies its employees' compensation by the number of years they have worked at the company. Top executives receive up to 4 percent of this sum annually; other employees receive up to 1.6 percent.

Fewer than one-fifth of all workers in the United States have a traditional defined-benefit pension, said Annika Sunden, an economist at the Center for Retirement Research at Boston College. The typical private pension pays about $6,000 a year.

At some companies, including the Interpublic Group, an advertising agency, and Mattel, the toymaker, executives can begin receiving a full pension at age 60.

According to the original contract for Mr. Gerstner, who is 60, his pension will be at least $1.1 million a year. The company will announce any additional benefits in a filing later this year, an I.B.M. spokesman, Rob Wilson, said.

That has angered some of I.B.M.'s 319,000 employees, many of whom lost benefits in 1999 when the company changed its pension program.

"It's just horrible that these companies are getting away with this," said Lynda P. French, a 57-year-old former I.B.M. software analyst in Austin, Tex., who used the Internet to organize employee opposition to the pension changes. "These C.E.O.'s are escalating their golden parachutes while they're cutting from the workers."

Ms. French said that I.B.M. had recently raised her health care premiums and that when her husband retires from the company, their health care benefits would be less generous than those received by previous generations of retirees.

Phil Nigh, a 41-year-old engineer in Essex Junction, Vt., who has worked for I.B.M. since 1983, said his pension would probably be 25 percent to 40 percent lower than it would have been before the company changed the plan.

"In my opinion, people lost a lot of trust in executive decisions" after the change, Mr. Nigh said. "They assumed I.B.M. would live up to its promises, and this kind of woke everybody up."

Mr. Wilson, the I.B.M. spokesman, said Mr. Gerstner's pension was not affected by the 1999 change because it was part of the contract between him and the company. "They are two separate things," Mr. Wilson said, referring to Mr. Gerstner's pension and that of other employees.

Since Enron's collapse, both Republican and Democratic lawmakers have said that some pension rules should be changed to prevent bankruptcy filings from hurting only lower-level employees. But the most prominent proposals, including President Bush's, would not alter basic rules covering executive pensions.

Pay consultants say the issue is often difficult to understand because many benefits are not made public, and those that are disclosed can be complicated.

One common perk is a life insurance policy on which a company pays the premiums. Executives can cash out of the policy while they are still alive or the benefits will be paid to heirs. Before the insurance company pays the benefits, it subtracts the combined amount of the premiums and pays this amount to the company—minus any interest.

"It's like the company is making an interest-free loan," said David M. Leach, the director of the compensation practice at Buck Consultants in New York. "It's losing the use of its money."

Many other executive benefits remain hidden from investors and employees because the S.E.C. does not require that all plans be fully explained.

"These are obligations that companies have that they are not disclosing to shareholders," said Carol Bowie, a director at the Investor Responsibility Research Center in Washington. "With executives, you're dealing with a group of people who have very few controls on what they can do."

Chairman HOUGHTON. It seems to me, if I could just take a little poetic license here, that may be the most important thing that I come out of this thing with, that there should be no inconsistency between the employees and the employers. And once you have that divergence, anything can happen, whether the system is right or the people are right.

Mr. URSPRUNG. Yes, sir.

Ms. YORK. Mr. Chairman, if I could just make one last comment——

Chairman HOUGHTON. Yes.

Ms. YORK. My heart goes out to these Enron employees who lost their pensions, but I would hope that this Committee and this Congress would be very careful in enacting legislation when for the great majority of companies with employee ownership and even companies with 401(k) plans, this works for a lot of Americans, and it works for a lot of Americans who would not have any pension plan otherwise. This is the only pension plan they have. So, please, just be very careful not to hurt those of us where it is working.

Chairman HOUGHTON. No, I understand what you are saying, and I thank you for those comments. Mr. Foley, would you like to——

Mr. FOLEY. Mr. Chairman, I think you hit on the crux of something there, and it is what the President said. If it is good for the captain, it is good for the sailor, and vice-versa.

I think what happened in Enron, and I have seen a lot of evidence, at least, we have got to tighten up some of the way companies do business. For instance, the off-balance sheet partnerships only required a 3 percent investment from an outside source in order to go off the books. That seems to be a low threshold in order to sweep an entire entity off your balance sheet.

I think it is also important to note, and I have seen this on many, many occasions, and I have heard horror stories while I was recently in California relative to stock options. The employee takes an employee incentive stock option, does not cash it but is owing taxes at the end of the year, and say the value of the stock declines precipitously. They owe it based on the day it was tendered. And so if they have lost money, they still owe taxes on what is called employment income. The chief executive officers, on the other hand, the have provided themselves a parachute by saying, when we tender our stock, we immediately pay taxes that are due. So some people in corporate suites have extra incentives and are not caught in that kind of shortfall.

One thing is for certain. This hearing and every hearing from now on has to be about protecting the valuable companies that exist today without besmirching their character or reputation, and again, going after those individuals, and if there are areas where SEC and accounting standards have to be changed, then I think we should be seriously endeavoring to find and isolate those instances, because if we do throw away, and I have known a lot of corporations that were struggling until the ESOP plans came into being and then the employees rallied together, bought the company, took control, made it to be one of Wall Street's great companies.

People who have retired in my district, I do not mean to mention companies, but UPS, they worked for Big Brown all their life. They had great retirements. They are thrilled to bits. If I talk about changing the way they are funding their pensions, they would have my head because they say, that is why we are able to live in Florida, because we were part of a great plan.

So we have all apologized to you. There are things I think this Committee could endeavor to do, and we ought to tighten up soon and make certain at the end of the day if it is good for the goose, it is good for the gander.

Chairman HOUGHTON. Thanks, Mr. Foley. Mr. Rangel, have you got any comments?

Mr. RANGEL. No thanks, Mr. Chairman.

Chairman HOUGHTON. Anybody else down here? No? I am supposed to say, there being no—would you like to comment?

Mr. URSPRUNG. Mr. Chairman, just one last comment.

Chairman HOUGHTON. Yes.

Mr. URSPRUNG. We are talking about aligning the interests of people involved in the company. My fellow chief executives officers will tell you that they do what is necessary in top executive compensation to be competitive in the world, and perhaps there is truth in that. I can tell you, being a chief executive officer, and I think you know, we are not going to self-correct. Our boards are not going to self-correct. Our trade associations are not going to self-correct and align interests. It takes a higher authority to make sure that those interests are in alignment and it is here.

Chairman HOUGHTON. Well, I think it takes a higher authority and maybe that higher authority is the citizenship of this country and just the abhorrence of what has happened.

We could go on forever. Rich, do you want to make a final comment?

Mr. TRUMKA. I wanted to respond to the original question that you proffered about what we can do, and how do you legislate trust. One whole facet has just been referred to of looking at the areas where there were conflicts and removing those conflicts so that if one layer of that defense falters, that the next layer could pick it up.

But when it comes to the 401(k)s, we have proffered several specific things. Give employees the right to sell their stock. Give them the right immediately, and this does not apply to the ESOPs and none of the legislation that I have seen to date applies to ESOPs.

The second thing is, make sure that there is independent investment advice.

The third thing is that if an employer provides a defined benefit plan, and those are not just union plans, those defined benefit plans are single employer plans and the *New York Times* article said that all of the executives, quite frankly, have those DB plans. If they have a DB plan for everybody, then they should be able to give stock in a 401(k) and have that as an investment option. But if they do not provide a DB plan to every employee, then they should be either able to give stock in the 401(k) or—or—have it as an investment option, but not both. That inherently limits the amount that could go in there, into 401(k), and protects employees.

And the last thing is equal representation on 401(k) plans. Put worker representatives on those plans so that the investment advisors, the actuaries, and everybody involved with that plan are equally beholden to the employees and management.

And the last thing I would say, Mr. Chairman, is, and I will leave this to your good devices, create some tax incentives to create defined benefit plans, not just defined contribution plans. Those could go a long way in securing the retirement future of all of our employees.

Chairman HOUGHTON. Okay. I appreciate that. Well said. I appreciate all your being here and your thoughts. I think it has been a terrific hearing, and maybe we can have some other thoughts on this later.

The hearing is adjourned.

[Whereupon, at 5:18 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of M. Kay Grenz, Vice President, Human Resources, 3M Company, St. Paul, Minnesota

On behalf of 3M, I am pleased to submit, for the record, written comments in response to the hearing on Employee and Employer Views on Retirement Security, which was held on March 5, 2002, before the Subcommittee on Oversight of the U.S. House of Representatives Ways and Means Committee. My name is M. Kay Grenz, and I am vice president, 3M Human Resources.

3M is a large multinational corporation with 2001 worldwide annual sales of just over $16 billion. We produce more than 50,000 products that are sold in nearly every country in the world. We have approximately 35,000 employees in the United States and a similar number abroad.

I'm proud to note that, in a few months, we will celebrate our centennial. Over our 100-year history, we have been intimately involved in the evolution of the current retirement security system. Today, we have a large number of 3M retirees who are reaping its benefits. In my statement, I would like to draw on 3M's decades of experience while addressing the general issue of retirement security.

The retirement security system that has evolved in the United States is an impressive achievement. It combines: (1)a very successful federal program (Social Se-

curity); (2) an extensive, voluntary employer-based pension system; and (3) individual savings.

For tens of millions of Americans, this three-part approach is the basis for a secure and comfortable retirement. The system works—in large part—because it provides incentives for employees and employers to participate.

Can the system be improved? Certainly. But I urge the members of this subcommittee, and all in Congress, to undertake any changes with great care. Changes should ensure that current protections and incentives are preserved and that all three parts of the current system continue to work in harmony. In particular, if changes were to discourage employer contributions to pension and 401(k) funds, a greater burden would be placed on individual savings and Social Security. This would be detrimental to the millions of Americans now saving for their retirement and to the nation as a whole.

The Current System Works for Millions of Americans

The current, three-part approach to retirement security works for the 56 million Americans who participate in 401(k), profit sharing and employee stock ownership plans (also known as ESOPs). Pension legislation enacted in June 2001 is expected to increase that number.

This system currently helps 60,000 U.S. 3M employees, retirees and their survivors build the resources they need for a comfortable and secure retirement. I would like to take a moment to describe 3M's Total Retirement Program.

The 3M pension plan: The foundation of the 3M Total Retirement Program is the 3M pension plan, which provides a lifetime, fixed monthly pension to retirees and their survivors. Currently, 25,000 U.S. retirees, survivors and former employees receive monthly pension checks from the company's defined benefit plan. This year, 3M pension payments will total about $375 million. These payments are secured by a pension trust that currently holds over $6.1 billion in assets.

This plan is funded entirely by 3M contributions and returns on fund investments. When returns on fund investments are not sufficient to cover the growth of fund obligations, 3M makes cash contributions to the fund to ensure that it has the assets to cover its obligations.

In each of the past six years, 3M has made a cash contribution to the pension fund. These contributions have ranged between $80 and $150 million annually. As of September 2001, the pension plan had assets equal to 103 percent of accumulated benefit obligations (the present value of pension benefits attributed to service to date) and 96 percent of projected benefit obligations (the accumulated benefit obligations including assumptions of future compensation levels).

3M's 35,000 U.S. employees bear none of the cost and none of the investment risk of the pension plan.

The 401(k) plan: 3M's Total Retirement Program also includes a voluntary retirement savings program or 401(k) plan. The plan currently has $4.7 billion in assets.

Over a year ago, 3M introduced a new program of retirement benefits designed to attract early-career job candidates; current employees were given the option of remaining with their original retirement program or moving to the new program. Both programs include a 401(k) plan, in which employees can invest up to 35 percent of their payon a before-tax basis (up to $11,000) and up to 9 percent of their pay on an after-tax basis. For the first 6 percent of their pay, 3M will match 35 cents or 50 cents for each dollar the employee invests (depending on which pension program the employee is under).

In addition, regardless of whether they choose to contribute to the 401(k), employees receive company-paid contributions based on 3M's financial performance.

Other benefits: 3M also offers retirees life insurance and access to low-cost medical, pharmaceutical and dental insurance.

To summarize, 3M offers a comprehensive retirement program that includes a pension plan, a 401(k) plan and low-cost medical, pharmaceutical, dental and life insurance. While every investment program involves some risk, the 3M retirement program allows participants to adjust the level of risk to suit their tolerance and their personal investment objectives.

In other words, for 3M employees, retirees and their families, the current system works well.

The 3M Retirement Program promotes Diversification of Assets

A central issue in the discussion of retirement security is the concern over an excessive concentration of company stock in an individual's overall retirement portfolio. Specifically, the concern is that a lack of diversification could jeopardize the employee's security if the value of the company's stock were to drop precipitously.

At 3M, we have stressed the advantages of diversification in our pension investments, in the rules by which we operate our 401(k) plans and in our communications to employees.

3M's pension fund contains a minimal holding in 3M stock. Although federal law allows up to 10 percent of a pension fund to be invested in company stock, less than 1 percent of the fund's $6.1 billion in assets are in 3M stock or 3M stock futures.

3M also encourages employees to build a diversified portfolio of investments within their 401(k) accounts. Although company contributions (matches and performance-based) are in 3M stock, 3M does not permit employee contributions to be invested into 3M stock. Instead, employees can choose from 11 core investment funds and can access more than 2,000 additional mutual funds (but not individual stocks) through a brokerage account.

Furthermore, employees can sell up to 50 percent of their 3M stock and transfer the proceeds into these 401(k) investment funds after they have completed five years of service with 3M, regardless of the employee's age. (Federal ESOP law mandates only that employees over age 55 be allowed to transfer up to 50 percent of their employer's stock into other investments.) Allowing employees to diversify the investments of more than 50 percent of their 3M stock could make it impossible for the plan's ESOP to satisfy the U.S. tax code's requirement that an ESOP be designed to invest primarily in employer stock.

Finally, 3M strives to inform and educate employees on the opportunities for and importance of a balanced investment strategy. Among other tools, the company provides employees with access to an online investment advice tool that offers investment recommendations and helps employees develop a comprehensive retirement plan consistent with their personal tolerance for risk. Nevertheless, employees are responsible for the development and application of such a strategy.

As a result of this emphasis on diversification, 3M employees-as a group-appear to have well-balanced retirement portfolios.

If one looks only at 401(k) accounts, 3M employees currently hold about 30 percent (or $1.5 billion) of total assets in 3M stock. By diversifying to the fullest extent allowable under current plan provisions, employees could reduce the 3M stock in their 401(k) accounts to 15 to 20 percent.

A final important note: If one looks at a typical 3M retiree's total retirement income portfolio-which includes the 3M pension plan, 401(k) accounts, Social Security and personal savings-we estimate that 3M stock constitutes less than 5 percent of total assets.

America Needs a Strong and Balanced Retirement System

I am sure the subcommittee appreciates the need for a strong and viable retirement system in this country, so I won't dwell on this point. I would like to make two observations, however.

First: This critical system has three parts, and changes to any one part will surely reverberate throughout the entire system. Changes that diminish the appeal of and participation in 401(k) and pension plans, for example, will necessarily increase Americans' reliance on private savings and Social Security. At a time when Congress is concerned about the solvency of Social Security and when the savings rate among Americans is at historic lows, such a change would seem to be unwise public policy.

Second: The legal and regulatory framework behind the current system is, like the system itself, an impressive achievement. It is richly complex and difficult to understand. The repercussions of a change in one area may not be immediately evident. Modifying such a system requires careful and thorough consideration. A well-meaning change could produce unintended but, nevertheless, harmful burdens that would be shouldered by our retirees and by those who are working hard to save for their retirement.

A Voluntary System Relies on Incentives

The current U.S. retirement security system combines a compulsory component (working Americans and their employers contribute to Social Security) and two voluntary components, which are individual retirement savings-including 401(k) accounts-and private pension funds established and maintained by corporations.

The point has often been made that the compulsory component-Social Security-was designed as a supplement to voluntary efforts, such as individual savings and company pension plans. One of the reasons why this voluntary system has worked so well for so long is that it provides reasonable and attractive incentives for both employees and employers.

For employees, the incentives are emotional and financial. Obviously, one of the primary emotional motivators is the desire for a secure and comfortable retirement.

This desire alone would prompt many individuals to save for their later years. Unfortunately, many would not. To further encourage these individuals, Congress has created financial incentives in the form of savings plans that offer tax deferral as a benefit of participation.

For companies, the incentives are similarly emotional and financial. Many companies, including 3M, established their pension funds because we felt a loyalty to employees and wanted to reward them for their years of service. We also recognize that employees often feel a corresponding loyalty to companies that establish and fund meaningful pension benefits.

In addition, we recognize that employee ownership of company stock-which, as I mentioned, we provide as a match for employee contributions to their 401(k) plans-gives employees a stake in the company's financial performance. This provides a powerful incentive for the innovative thinking, diligence and dedication needed for success in today's competitive markets. Also, because they are aware of the company's goals and strategies, employees are usually highly supportive investors.

Many companies establish mechanisms that promote employee stock ownership; these mechanisms include discounted stock purchases, stock options and awards tied to financial performance. In addition to the emotional benefits, Congress has crafted additional tax provisions that make it financially beneficial for companies to contribute stock to employees' 401(k) programs. This tax benefit varies depending on the number of shares held in the plan and other factors. In 2001, the tax benefit to 3M was approximately $15 million.

If the tax benefits enjoyed by employees and employers did not exist, many individuals would still save for retirement and many companies would still provide pension benefits and promote employee stock ownership. But far fewer would do so, for obvious reasons.

For individuals, it is always hard to balance immediate needs, such as a mortgage or car payment, against long-term needs, such as retirement. The one need is pressing; the other is easy to set aside.

Corporations, too, must balance needs. They must allot their limited funds among salaries, health care and pension benefits, dividends, capital investments and so on. The amount that is contributed to 401(k) plans is clearly influenced by the tax advantages that companies receive for making these voluntary contributions. Absent those advantages, the balance among competing needs would be recalculated.

In short, we believe that the company's contributions to 401(k) plans are good for 3M employees. We believe that those contributions are particularly valuable when they come in the form of 3M stock, because the tax advantages allow a larger contribution than we could otherwise make and because the company benefits when employees have an ownership interest in the company's performance. We think that a 30 percent concentration of 3M stock in the 401(k) program is not unreasonable, in the context of a broader retirement portfolio. And we recognize that the loss of tax advantages would lead to a reevaluation of the amount 3M can responsibly contribute to employees' 401(k) accounts.

Recommendations for Congressional Action

Recent events show us that America's overall retirement system can be improved. Millions of American workers rely on their employer's pension and 401(k) plans as the foundation of their retirement savings, and recent events show that careful additional steps may need to be taken to ensure retirement security.

3M supports changes that increase worker protections when those changes preserve the incentives for employer contributions and the benefits that come from employee stock ownership.

As I mentioned earlier, 3M allows employees the maximum diversification permitted under ESOP regulations-that is, 50 percent of employer-contributed stock-as soon as the employee has spent five years with the company. This approach has yielded a very appealing outcome.

Because of the tax treatment of 401(k) programs, 3M is able to make a significantly more generous contribution to employees' retirement funds than would be possible under other circumstances. Employees have had a reasonable opportunity to diversify-such that 3M stock constitutes about 30 percent of their 401(k) plans and about 5 percent of their overall retirement portfolio-and yet they still have the motivation that comes from owning company stock.

Changes that would adversely affect this program-including additional limits on employee stock ownership, reduced incentives for employee saving and reduced tax benefits for employer contributions-would likely produce adverse effects on our employees.

We also support equal treatment for all employees during the blackout periods that are periodically necessary for administrative and other reasons. We believe

that participants and beneficiaries should be given reasonable advance notice of an approaching blackout. We oppose arbitrary limits on the length of blackouts.

Finally, we think that it is logical and most convenient for participants and beneficiaries if employers are able to offer them access to balanced, professional investment and other financial education. So that participants have the tools to diversify wisely, any changes in diversification requirements should permit employers to provide access to meaningful, cost-effective investment advice, without employers incurring liability.

The Importance of Balance

In closing, I would like to commend Congress for tackling a complex issue that is of great importance to all Americans. As you proceed, I urge you to be guided by a "do no harm" approach so as to avoid any changes that might harm a system that works so well for so many. Furthermore, I would like to reemphasize that America's retirement security system is based on a balanced reliance on compulsory Social Security, voluntary individual savings and voluntary corporate contributions. We need all three. Any changes to the system should not change the balance among these three components. If one is impaired in any way, an unsustainable burden will be placed on the others.

Thank you for the opportunity to submit this statement.

For additional information, contact: Tom Beddow, vice president, 3M Public Affairs and Government Markets, Tel: (202) 331–6948, or June D'Zurilla, manager, 3M Federal Government Affairs, (202) 331–6950

Statement of the Industry Council for Tangible Assets, Inc. (ICTA), Severna Park, Maryland

While coin investing is certainly not unique to the United States, the market for rare U.S. coins is the most highly developed coin market in the world. From 1795—1933 the U.S. produced precious metals coinage for use in commerce. Twice during the US' two-hundred-year history, precious metals coins were recalled and melted by the government. These meltdowns helped transform U.S. coinage from common monetary units into numismatic investments.

It is generally accepted that upwards of 95% of original mintages were lost due to mishandling or melting. The small surviving population of coins forms the backbone of the investment market for rare U.S. coins.

Prior to 1981, *all* rare coins were qualified investments for individually-directed retirement accounts. In fact, rare coins *remain* as qualified investments today in certain corporate pension plans. The Economic Recovery Tax Act of 1981 eliminated the eligibility of rare coins for IRAs by adding Section 408(m) to the USC. Section 408(m) created an arbitrary category of "collectibles" which suddenly were no longer eligible investments. Regrettably, in 1981, the precious metals/rare coin industry had no trade association to voice objections, so this provision was enacted without opposition or benefit of comment.

The Industry Council for Tangible Assets, Inc. (ICTA) was formed in 1983 as a direct result of the 1981 legislation. Had ICTA existed in 1981, we believe that the organization could have easily demonstrated how the inclusion of precious metals as collectibles was clearly a mistake. For example, in his testimony before the Senate Finance Subcommittee on Savings, Pensions and Investment Policy, the then Assistant Secretary of the Treasury for Tax Policy, John E. Chapoton, lumped gold and silver into a collectibles category of "luxury items" that also included jewelry. Clearly, for centuries the U.S. Federal Government has disagreed with this characterization insofar as it is precisely those products that are stored in the government's Fort Knox facility. Indeed finally, in the Taxpayer Relief Act of 1997, we did prevail and were successful in having precious metals (gold, silver, platinum, and palladium bars and coins) restored as qualified IRA investments.

It is interesting to note that Mr. Chapoton concedes the investment value of collectibles. However, once again, Mr. Chapoton applied certain collectibles criteria to rare coins and precious metals that were **not** appropriate. In fact, he often cited examples of the uses of jewelry and silverware as though they applied to rare coins and precious metals. (His arguments were similar to stating that, while cotton may be an essential ingredient in the manufacture of clothing fabric, disposable cotton balls, and currency banknotes, that does not mean that banknotes are the same as cotton balls.) The testimony relating to the consumption aspect (for example, a painting or antique rug may be enjoyed for its original intended function in addition to its investment potential) is especially irrelevant, since a coin's original function

is to be spent—clearly not something the owner of a rare $20 gold coin now worth $500 would do. A bill pending in the U.S. Congress, S.1405, would correct this situation and restore certain coins as qualified IRA investments.

Expanded Safeguards

Beginning in 1986, the market in rare coins became even more viable for investors with the creation of nationally-recognized, independent certification/grading services. These companies do not buy or sell rare coin products. They are independent third party service companies whose sole function is to certify authenticity, determine grade, and then encapsulate each rare coin item. Each coin is sonically sealed in a hard plastic holder with the appropriate certification and bar coding information sealed within, which creates a unique, trackable item. This encapsulation serves also to preserve the coin in the same condition as when it was certified.

These companies employ staffs of full-time professional graders (numismatists) who examine each coin for authenticity and grade them according to established standards. Certified coins (as the resulting product is known) are backed by a strong guarantee from the service, which provides for economic remuneration in the event of a value-affecting error.

Unlike most other tangible assets, certified coins have high liquidity that is provided via two independent electronic trading networks—the Certified Coin Exchange (CCE) and Certified CoinNet. These networks are independent of each other and have no financial interest in the rare coin market beyond the service they provide. They are solely trading/information services.

Encapsulated coins now enjoy a sight-unseen market via these exchanges. These electronic trading networks function very much the same as NASDAQ with a series of published “bid” and “ask” prices and last trades. The two networks offer virtually immediate, on-line access to the live coin exchanges. The buys and sells are enforceable prices that must be honored as posted until updated. Submission to binding arbitration, although rarely necessary, is a condition of exchange membership. Just as investors in financial paper assets access the marketplace via their stockbroker, investors in rare coins access the on-line market via their member coin dealer(s). Trades are entered on these electronic networks in the same manner as trades are entered on NASDAQ, with confirmation provided by the trading exchange. These transactions are binding upon the parties.

Why Rare Coins Provide Needed Diversity in Investment Portfolios

Most brokerage firms and investment advisors recommend that persons saving for retirement diversify their investment portfolios to include some percentage of tangible assets that are negatively correlated to financial (paper) assets. Tangible assets tend to increase in value when stocks, bonds and other financial assets are experiencing a downward or uncertain trend. It is important that investors have both tangible asset options—precious metals *and* rare coins, just as they have the option of stocks and/or bonds.

The value of precious metals products fluctuates in direct proportion to the changes in price for each metal (gold, silver, platinum and palladium) on the commodity exchanges. The rare coin market is often *related* to the precious metals markets; however, rare coins have the added factor of scarcity, which adds to the stability of the market. For instance, a U.S. $20 gold coin contains.9675 troy ounces of gold (almost a full ounce.) While the bullion-traded gold one-ounce American Eagle coin’s price will fluctuate daily in accordance with the spot gold price, the U.S. $20 will resist downward pricing since its value is in both its precious metals (intrinsic) content and its scarcity factor. To illustrate, today, with the gold spot price at $292, a one-ounce gold American Eagle bullion coin ($50 face value) retails for $303.50. The minimum investment grade U.S. $20 face value gold coin (.9675 ounces of gold) retails for $424. The American Eagle gold coin has a higher face value and a slightly higher gold content, yet the value of the U.S. $20 rare coin is $120 greater. While even “blue chip” stocks can become worthless (Eastern Airlines, for example), precious metals and rare coins can never be worth less than the higher of their intrinsic or legal tender face values.

What’s Wrong With the Current Law

An independent study* prepared for the Joint Committee on Taxation found that the inclusion of rare coins and precious metals in a diversified portfolio of stocks and bonds increased the portfolio’s overall return while reducing the overall risk of that portfolio. In fact, rare coins remain a qualified investment product for corporate pension plans. The average American investor should not be penalized for not hav-

ing that particular tax-advantaged program available to him/her, and it would be only equitable to permit such investment options for those individually-directed retirement accounts. Removing current restrictions would allow small investors, whose total investment program (or most of it) consists of their IRAs or other self-directed accounts, to select from the same investment options currently available to more affluent citizens.

In addition, the current law creates the inequitable result that occurs when an individual leaves one job and its related pension and profit-sharing plan. When employees leave or are terminated, they are usually excluded from the employer's pension and profit-sharing plan. There is currently no provision for a conduit IRA that allows them to transfer any rare coins that may be part of this plan. The result is that the item *must* be liquidated—regardless of whether such liquidation is to the employee's benefit or detriment at that time. The only alternative—accepting the distribution in its rare coin form—renders this a taxable event. This is obviously an inequitable and unintended result.

Benefits of S. 1405

S.1405 simply restores rare coins to the menu of options for investors and allows them to diversify and stabilize their retirement portfolios. It would also allow these products to be rolled over from one plan to the employee's conduit IRA or new plan.

Important Provisions of S. 1405

- Investment coins purchased for individually-directed retirement accounts must be in the possession of a qualified, third-party trustee (as defined by the IRS), *not* the investor.
- Coins eligible for inclusion in an individually-directed retirement account must be certified by a recognized third-party grading service, i.e., graded and encapsulated in a sealed plastic case. Each coin, therefore, has a unique identification number, grade, description, and bar code.
- Only those coins that trade on recognized national electronic exchanges or that are listed by a recognized wholesale reporting service are eligible for inclusion.

Recent Action Taken by the U.S. Congress and the States

The Taxpayer Relief Act of 1997 restored certain precious metals bullion as qualified investments for IRAs. This was the first step in a two-step process. The restoration of certain certified coins will complete the restoration of these important products as acceptable for individually-directed retirement accounts.

The Joint Committee on Taxation has concluded that the inclusion of rare coins would have negligible economic impact on federal revenues.

There is broad, bipartisan support for the inclusion of rare coins as qualified investments in individually-directed retirement accounts, led by Senator John Breaux.

The independent study* done for the Joint Committee on found that the inclusion of rare coins and bullion in a diversified portfolio of stocks and bonds increased the portfolio's overall return at the same time that it reduced risk. By purchasing rare coins in their IRAs, investors are able to keep tangible assets in their retirement plans over the long-term and, when they increase in value, sell them for a profit and reinvest the proceeds without having to immediately pay taxes on the gain.

Some of the conclusions of the study done for the Joint Committee on Taxation appear to have relevance to current economic conditions. The study reported that stocks and rare coins had the highest rates of return over a 20-year period and the statistical analyses reveal that rare coins are inversely related to stocks in a stock bear market (*e.g.,* the collapse in stocks in 1987 triggered a major bull market in rare coins) but also, on occasion, are positively related to stocks during stock bull markets (*e.g.,* the recovery in stocks after the '87 crash did nothing to slow the bull market in rare coins). For the majority of the period analyzed, the study showed that rare coins did best when bear markets in stocks sent investors looking for alternative investments.

Twenty-six states have exempted coins and precious metals from sales taxbecause they recognize them to be investment products. In seven additional states, such exemption legislation is under consideration.

**An Economic Analysis of Allowing Legal Tender Coinage and Precious Metals as Qualified Investments in Individually-Directed Retirement Accounts* by Raymond E. Lombra, Professor Economics, Pennsylvania State University, February, 1995; updated April, 2001. Available from ICTA, PO Box 1365, Severna Park, MD 21146–8365; telephone 410–626–7005; e-mail ictaonline.org.

We believe that this legislation is consistent with Congress' desire to encourage U.S. citizens to save/invest more and to take personal responsibility for retirement. In addition, tangible assets are real, not paper, investments that will never lose their intrinsic value and which maintain an orderly, easily-transacted, and portable marketplace. They provide today's investors with security for the future just as they have for thousands of years.

Statement of the Pension Reform Action Committee

Introduction

The Pension Reform Action Committee (PRAC) is a joint venture of the Employee Ownership Institute and Employee-Owned S Corporations of America and is the only organization that speaks exclusively for America's private, employee-owned businesses on the issue of pension reform. PRAC believes that, as Congress looks to enact meaningful reforms in light of the repercussions of Enron, it is critical that policymakers adopt an approach that seeks to bolster, rather than inadvertently harm, the pension savings of workers in private employee-owned U.S. businesses.

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

The principle of employee ownership, however, is threatened by certain legislative proposals that would make draconian changes to laws governing pension and defined contribution plans. Changes to current law regarding the ability of employees to diversify out of non-publicly traded company stock, or to impose limits on the amount of non-publicly traded company stock that can be held in an employee stock ownership plan (ESOP), could devastate the ability of employees in private companies to save for their retirement by jeopardizing the valuation and financial strength of their employer.

The Joint Committee on Taxation (JCT) report ("Present Law and Background Relating to Employer-Sponsored Defined Contribution Plans and Other Retirement Arrangements") prepared for the Committee on Ways and Means hearing on February 26, 2002 only touches on this important issue. Page twenty-six notes that "Administrative issues may arise as a result (of proposals to restrict investment in employer stock), particularly in the case of employer stock that is not publicly traded or in the case of a leveraged ESOP. Special rules may be needed to address these issues." As this statement details, private companies will face much more than "administrative issues" should current employee ownership rules be changed.

Private companies have unique concerns relating to diversification

Two particular features distinguish private from public business. First, the stock of a private business cannot be sold on the public market. When company stock is sold, *the only purchaser of the shares is the company itself*. Thus, any change to current law that facilitates substantial sales of private company stock will place an enormous strain on the capital of the company-buyer. Proposals to change existing diversification rules for non-publicly traded stock could threaten the viability of large numbers of private companies. If Congress changes current law diversification rules for private companies, such changes will create a "put" on vast sums of capital in every private business in the country that gives company stock to its employees. This in turn will place an enormous strain on the capital of the company-buyer, potentially forcing up leverage ratios and reducing the company's ability to fund ongoing operations and growth.

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

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

The second related distinction between public and private companies is that a private company's stock value does not derive from the public markets, but rather from

a private valuation of the company's assets, liabilities and cash flow. *Regardless of whether the employees choose to divest of these shares*, any change to current law that facilitates the sale by employees of large amounts of private company stock creates a massive contingent liability for the company buyer. The automatic result of this liability is that the company's stock value will fall, *resulting in a devaluation of the employees' stock accounts*, thus harming the very savings account Congress ostensibly is seeking to protect.

Employers benefit

Private employee-owned companies are typically "open book" companies, where employees are informed investors in the company. Employee stock ownership allows all employees, rather than only high-level executives, to save and have a stake in the success of their company. Government and private studies document that employee ownership leads to increased productivity and compensation, worker satisfaction, and lower turnover—all keys to financial success and growth.

Aspen Systems Corporation (Aspen), a service company primarily fulfilling Federal Government contracts, is a private company wholly owned by the Aspen ESOP. Aspen would have been sold by its parent company had it not become employee-owned. The ESOP structure has allowed it to grow from $58 million in sales and 1,000 employees in 1993 to $124 million in sales and more than 1,600 employees in 2001. Aspen and its employees believe this growth is directly attributable to the "enhanced dedication and increased productivity" of its employee-owners.

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

Employees benefit

Private companies provide a wide array of savings plans—from 401(k) to profit sharing plans to ESOPs for millions of American workers. In the absence of such company-sponsored plans, many Americans, already facing record low (if not negative) savings, would have little, if any, meaningful savings amassed. This is critical particularly as Social Security can no longer be relied upon as the sole source of retirement funding.

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

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

Conclusion

The Pension Reform Action Committee hopes to work with the Committee to ensure that any pension reform considered this year protects both America's private companies and the retirement savings of millions of American workers in these businesses. To meet this goal, the unique nature of private companies and the benefits they provide to their employees must be considered separately. At this point, only two pension reform bills—H.R. 3669 introduced by Representatives Rob Portman (R–OH) and Ben Cardin (D–MD) and S. 1971 introduced by Senator Chuck Grassley (R–IA)—exempt private companies from new mandatory diversification rules. This distinction is critical to the viability of private employee-owned companies and the health of the retirement savings of their employees and must be preserved.

Statement of the Pension Rights Center

The Pension Rights Center submits for the record testimony addressing employee concerns in 401(k) plans and other uninsured savings plans in light of the Enron debacle.

Over the past 25 years, the Pension Rights Center has taken the lead in targeting inequities in the nation's retirement programs, and proposing realistic solutions. Working with a bipartisan coalition of retiree, labor, and women's groups we have secured the enactment of five federal laws that are providing much-needed benefits to millions of retirees, widows, and divorced spouses. We have also helped thousands of people with their pension problems, and worked with employees and retirees from companies around the country to help stop cutbacks in their pension and retiree health benefits. Over the years, we have heard our share of tragic stories. But what makes Enron different is the magnitude of the saga, the number of people hurt, and the fact that it so dramatically highlights so many gaps in federal retirement laws that need to be addressed to adequately protect workers.

The story of Enron is unfolding daily. The company created a complex web of seeming improprieties replete with shell companies, sham partnerships and a host of other elaborate schemes devised for the purpose of hiding losses and creating financial statements that misled the workers into thinking that the company was highly profitable. According to excerpts from a special committee investigative report of the Enron Corporation's board detailed in the *New York Times*, "There was a culture of deception where every effort was made to manipulate the rules and disguise the truth as part of an effort by executives to falsely pump up earnings and earn millions of dollars for themselves in the process."

Millions of individual stockholders, investors in mutual funds, and participants in state retirement funds have been affected by Enron's demise. But no one has lost more than the Enron employees, who have lost their jobs, their confidence in the stock market, and virtually all of their 401(k) money.

Enron workers thought of the company as family. They had put their life savings into their 401(k) plan because they trusted reports by Enron CEO Kenneth Lay and other company officials that the stock was soaring and the company was in stronger shape than ever. But while they were putting money into the 401(k), the company officials were selling Enron stock, presumably because they knew the company was in serious financial trouble. To make matters worse, even if they had known the facts, the portion of company stock they had received as "matches" to their 401(k) contributions was locked in until they reached age 50. Then, when the stock price continued to drop, they learned that they could not even shift their own contributions out of company stock because of a "blackout" imposed while the plan changed administrators. Through all of this the company had the audacity to tell employees not to worry because, "The Enron savings plan is an investment vehicle for long-term financial goals."

We now know that the only ones who planned to benefit in the "long-term" were company officials.

In the aftermath of the Enron tragedy, the Pension Rights Center has been inundated with calls and letters from reporters, policymakers and ordinary citizens who ask us, "What does this mean? Is retirement money safe? What can be done to prevent future Enrons?

What is clear is that strong measures are needed to restore confidence in private retirement plans. Just as Studebaker's bankruptcy in the 1960s prompted Congress to pass the Employee Retirement Income Security Act (ERISA) in 1974, Enron's failure may be the catalyst needed to close the serious gaps in the law that this terrible tragedy has highlighted.

It is critical that Congress enact protections that will help assure that people's retirement money is safe, to ensure that Enron-type situations cannot occur again, as well as on ways of making sure that individuals who have been harmed in such cases will be made whole. The Enron situation also raises broader issues, such as whether there is an over-reliance on 401(k) plans and other uninsured savings plans, and whether the shift to these do-it-yourself savings plans represents sound policy.

Finally, beyond Enron, there are other related retirement security concerns that we believe should be addressed. These include concerns of the one-half of the workforce not in any kind of retirement plan and widowed or divorced women.

Preventing Future Enrons. What needs to be done to ensure that the kinds of losses experienced by Enron employees cannot happen again?

First and foremost there must be strong measures to ensure proper diversification of investments within 401(k) plans. If an employer makes matching contributions in the form of its own company's stock (rather than cash), employees should be able

to move out of that stock and into other 401(k) investments within a reasonable amount of time. Many bills, including the Employee Pension Freedom Act introduced by Congressman George Miller (H.R. 3657), the Pension Protection and Diversification Act introduced by Congressman William Pascrell (H.R. 3640) would allow such a shift shortly upon, or shortly after, an employee is vested in the matching contributions. These are important first-step measures, but to make these reforms stick, Congress must ensure that companies cannot circumvent these provisions by simply setting up Employee Stock Ownership Plans (ESOPs), plans funded primarily by employer contributions of company stock. It has become too easy for employers to set up what are called, "KSOPs," combinations of 401(k) plans and ESOPs.[1]

Employer groups take the position that if employees are allowed to freely shift out of company stock and into other plan investments, employers will stop matching their employees' 401(k) contributions.[2] This is unlikely since, as the Congressional Research Service recently pointed out, there are a variety of incentives to encourage employers to make matching contributions in stock.[3]

But allowing employees to move out of company stock that used as a match for employee contributions is only one part of the diversification problem. That is because employer matching contributions typically make up a relatively small part of the company stock held by 401(k)s. (In the case of Enron's 401(k), 11 percent of the company stock was attributable to employer matches.) There is also a need to limit the amount of employees' own 401(k) contributions that can be invested in company stock.

The simplest approach would be simply to apply the same limit 10 percent limit now imposed on traditional pension plans (and on 401(k)s where employers direct plan investments). After all, if this kind of diversification is required when employers (and the government) bear the risk of loss, why should less diversification be required when employees bear the risk? The Pension Protection Act (H.R 3463) introduced by Congressman Peter Deutsch applies a 10 percent limit to employees' contributions in company stock. The Pension Protection and Diversification Act would apply a higher limit: Employees would be permitted to put up to 20 percent of their 401(k) assets in company stock. Another approach would prohibit employers that provide the matching contribution in stock from offering employer stock as an option to employees.[4] Another idea for promoting diversification would be to reduce the tax favored treatment for employee contributions invested in company stock each year, exceeding a specified percentage.

We have heard the argument that employees will balk against any restrictions on how much company stock they can invest in 401(k) plans—that they will view such limits as restrictions on "personal choice." In fact, limits of this kind would not restrict personal choice. Individuals are free to invest their personal money any way they wish. Congress has given contributions to 401(k)s special tax treatment in order to help them provide for a secure retirement. The revenue loss to the Treasury

[1] The Pascrell provision would allow participants in ESOPs to switch into other investments earlier than is now permitted. (At age 35 and 5 years of service, rather than the current, age 55 and 10 years of service.) An in-depth examination of ESOPs from a workers' perspective is urgently needed. Once rare, these plans, which Yale Law Professor John Langbein recently described to the Senate Committee on Governmental Affairs as "tools of corporate finance masquerading as pension plans," are increasingly substituting for other, more diversified retirement plans. Statement of Professor John H. Langbein, January 24, 2002.

[2] They make the same argument in opposition to another proposal in the Pascrell legislation that would reduce the tax deduction given to company stock contributed by employers from 100 percent to 50 percent, to reflect the fact that stock contributions are considerably less valuable to employees than cash contributions, and to encourage companies to contribute cash rather than stock.

[3] "Contributions of company stock are preferred over cash contributions by some employers because (1) they do not affect the company's cash flow; (2) are not recorded as an expense on the company's income statement, so they do not reduce reported profits; and (3) are fully deductible for tax purposes at the share price in effect when they were contributed. Making contributions of stock also puts shares into the hands of a group of people—the firm's employees—who are less likely to sell their shares either when there is a hostile tender offer for the company or when the firm's reported profits are less than expected." Patrick J. Purcell, "The Enron Bankruptcy and Employer Stock in Retirement Plans, January 22, 2002, pp CRS–4—CRS–5. Matches generally are needed to attract top-level employees. They also help encourage more lower-paid employees to contribute to the plan, which increases the amounts that higher-paid employees can contribute under the Internal Revenue Code's "nondiscrimination" rules.

[4] It would also be possible to permit employees to have higher concentrations of company stock in their 401(k)s if they were also participants in other diversified plans, but this would be extremely complex to administer, and, as happened at Enron, the benefits provided by the other plans could be insufficient to provide sufficient retirement security in the event of a company bankruptcy.

resulting from the tax subsidy for employer-sponsored retirement plans this year amounts to nearly $90 billion, the largest of all of the federal tax expenditures.[5] There is simply no justification for all taxpayers to pay higher taxes (or receive less in government services) to subsidize what is universally acknowledged to be highly risky investment strategies.[6]

There are other types of structural reforms that might help prevent future Enrons. These include measures aimed at avoiding conflicts of interest, such as those present in the Enron situation, and encouraging employees who suspect wrong doing to communicate their concerns to the government and others who may be in a position to protect employees.

For example, one long-overdue reform would be to ensure that the 401(k) plan's accountant is free to serve a watchdog function by being independent of the company, as contemplated by Congress in 1974. This would simply require overturning an Interpretive Bulletin issued by the Labor Department in 1975 that permits the accountant for the company to also be the plan's accountant. It would also be possible to require the appointment of an independent fiduciary to protect against conflicts of interest in 401(k) and other plans holding company stock. Another reform would be to set up a "bounty" program to reward whistleblowers who provide information to the Labor Department about unlawful actions by plan officials. Just as important, would be to strengthen legal protections for people who blow the whistle, and are punished by their companies for their efforts.[7]

Finally, the deterrents against unlawful behavior should be increased by allowing the government to recover punitive damages in civil actions when people involved in the running of a plan deliberately defraud employees, and increasing the criminal penalties. Under current law, in civil actions the most that is likely to happen is that a court will tell the wrongdoers to put the money lost by participants back into the plan. Plan fiduciaries convicted of criminal activities can be sentenced to up to five years in prison or fined, or both.[8]

Making Employees Whole.

The Enron employees are fortunate in having been able to find able lawyers to sue the company officials that ran their 401(k) plan, and to have the help of congressional committees and the media in ferreting out the officials' unlawful actions. But there is a very real danger that they will not be made whole for their losses because of short-comings in the laws.

If the people who ran the 401(k), the "plan fiduciaries," knew that the stock was plummeting while encouraging employees to load up on that stock, a court is very likely to find that they have violated their legal obligations to act solely in the interests of plan members, and to hold them personally liable to pay money back into the plan. But there is no requirement that they be insured. In Enron's case, there is a "fiduciary insurance" policy estimated to be about $85 million. But the Enron employees lost almost $1.3 billion—more than ten times the amount of the policy. An urgently needed reform measure is a requirement that everyone responsible for running private retirement plans, and investing plan money, be fully insured. Congressman Miller's bill would require fiduciary insurance or bonding to cover such losses. Another reform would be to give employees with claims for fraud under a 401(k) plan the same standing in bankruptcy as secured creditors.

Equally important, if employees are to be made whole, the law must be clarified in a number of respects. For example, the law should specify that individuals acting unlawfully be required to restore losses to individual participants, not just to the plan. Similarly, it should make plain that company officials, such as Enron CEO Kenneth Lay, who make misleading statements to employees can be sued (if those misrepresentations cause losses to the employees), even if the officials claim that they had nothing to do with the running of the plan. The law should also make clear that employees can sue accountants, lawyers, actuaries and others who participate in unlawful actions that cause losses to employees. And, finally, courts should be

[5] This subsidy, which includes the revenue loss resulting from public and private retirement plans other than Social Security (including Keogh plans) is larger than that provided for home mortgage interest and employer health insurance deductions. Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2001–2005* Prepared for the Committee on Ways and Means and the Committee on Finance, April 6, 2001, p. 22.

[6] Financial planners routinely counsel clients against holding more than five percent of a single stock. When the stock is the in the company the employee works for, the risk of loss is compounded by the possibility that the employee may also lose his or her job.

[7] A bounty program currently administered by the Internal Revenue Service provides 10 percent of any recovery to individuals providing information about party-in-interest transactions which leads to the imposition of excise taxes.

[8] 18 U.S. Code Section 664.

able to award the same kinds of remedies and attorney's fees to employees suing under pension laws that they award under other worker protection laws.

Business lobbyists are claiming that adopting reform measures will lead to "over-regulation" of 401(k) plans, and discourage companies from offering them. In support of their arguments, they trace the decline of traditional pensions to congressional enactment of laws that made those plans fairer and more adequately funded. In fact, it is equally likely that the number of traditional plans declined because of reduction of regulation by administrative agencies, that invited the development of 401(k)s, the "raiding" of plan assets, and the expansion of plans that only benefit executives, so-called "nonqualified" deferred compensation plans. As the Enron investigations continue, it is increasingly apparent that the problem is "under-regulation," not over-regulation.

Broader Policy Issues. Although the focus of this hearing is on the losses in the Enron 401(k), it is important to realize that these losses had such a dramatic effect on Enron employees because of other factors. As described by the *Wall Street Journal*, Enron, like so many other companies, had taken advantage of the leeway provided by accounting practices, and lax federal regulation, to cut back on the employees' underlying pension plan.[9] In 1987, Enron froze that plan, which provided lifetime, risk-free benefits guaranteed by the Federal Government, and used its "surplus" assets to create a "floor offset" plan that effectively relied on company stock to provide benefits. Nine years later, that plan, in turn, was replaced by a barebones new type of hybrid pension plan (that cut the expected benefits of older employees), supplemented by the 401(k). All of these changes were highly technical maneuvers that enabled the company to dramatically reduce the company's pension liabilities, and in so doing, increase the pension "surplus" in the fund. The company then took advantage of an accounting rule to post the earnings of the pension fund on the corporate financial statements—thus artificially boosting the profits reported to investors, and the value of executive stock options.

Another Pension Rights Center concern is that even if the employees had been aware of how they were being short-changed—and why—there would have been nowhere within the Executive Branch of the government for them to go. That is because there is no advocate within the Executive Branch to represent the interests of employees with pension policy concerns. There is no ombuds-type office charged with identifying gaps in the laws, or developing policies to close those gaps. There is also no one to speak for employees in interagency deliberations or to present their views to Congress. In this all-important respect, ERISA differs from other worker, consumer, and investor protection laws. We believe that now, 28 years after the enactment of the law, the time has come to create such an office.[10]

As far as we know, the Enron employees, like others around the country, did not protest the changes in their retirement plans in 1987 and 1996. The shift away from traditional pensions to 401(k)s and other savings plans has been very popular. It has been encouraged by Congress and the Administration, and heavily marketed by financial institutions and the financial media. Employers have welcomed the tremendous cost savings resulting from the shift, and employees have enthusiastically embraced the concept that they could become 401(k) millionaires. Little attention has been paid to the transfer of responsibility from employers to employees, or to the transfer of risk from pooled, professionally run arrangements backed by the government, to uninsured individual account arrangements, invested by ordinary workers who often, regardless of how much financial education they are offered, simply do not have the time, inclination, or expertise to enable them to make the "right" investment choices. How many rank and file workers living paycheck to paycheck have the time or inclination to figure out allocation strategies, or compare the performance of competing funds. Ironically, the House-passed investment advice bill supported by business groups and President Bush, would create serious conflicts of interest problems of its own rather than addressing the problems highlighted by the Enron case.

We are concerned that just as Enron was a victim of its own hype, 401(k)s may be equally vulnerable. For years, the Pension Rights Center has taken the position while that 401(k) plans are a good supplement to other plans, they are lacking as a stand-alone arrangement. Yet currently one-half of 401(k) participants have the

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[9] Ellen E. Schultz and Theo Francis, "Enron Executives' Benefits Kept on Growing As Retirement Plans of Employees Were Cut," January 23, 2002.

[10] A bill to create such an office was introduced by Senator Tom Harkin in the last Congress. The Pension Participant Advocacy Act of 2000, S.6475, was modeled on a similar type of office of Advocacy at the Small Business Administration, the National Taxpayer Advocate at the Internal Revenue Service and the Labor Department's Women's Bureau. Congressman Miller's bill includes a provision for the development of this office.

401(k) as their only private retirement plan, and half of all 401(k) participants have less than $12,000 in their accounts. Add to that the recent fluctuations in the market, and the uncertainty of the economy, and there could be even greater cause for concern.

Finally, the Pension Rights Center strongly supports the Retirement Opportunity Expansion Act of 2001, introduced by Congressman William Coyne, that would address many of the broader "big picture" problems in the retirement income arena by expanding pension coverage for low-wage workers, women and creating additional incentives for small businesses to provide pension coverage for employees. The bill, for instance, would allow increases in widow's benefits under pension plans and require spousal consent before an employees could cash out their 401(k) accounts; it would also establish SMART plans that would combine some of the best features of traditional employer-paid plans with the portability of 401(k)-type plans and provide benefits that are insured by the Federal Government.

Last year, the Center convened an inclusive, bipartisan public policy forum called the Conversation on Coverage. Funded by the Ford Foundation and the W.K. Kellogg Foundation, the Conversation brought together a diverse array of voices—business, labor, consumer, retirees and women's organization—to launch a national dialogue on ways of increasing coverage for the 50 percent of the population without any kind of pension or savings plan. We now have a unique opportunity to expand the scope of the Conversation, and reexamine these issues in light of Enron. The Conversation's goal will be to develop plans that are in the best interests of employees and employers—examining SMART plans as well as an array of other approaches—to determine how to best provide coverage to millions of Americans, particularly low and moderate wage-earners.[11]

Statement of J. Michael Scarborough, Scarborough Group, Inc., Annapolis, Maryland

Overview of The Scarborough Group, Inc.

The Scarborough Group Inc. is an independent investment advisory firm specializing in helping people prudently manage their 401(k) assets. Presently, the company manages nearly $1.5 billion in retirement assets for 8,700 clients across the country.

When Mike Scarborough began advising his clients about the assets they were holding within their savings plans he realized quickly that his clients, with proper allocation advice and management, could potentially boost and help protect their retirement savings. Mike established The Scarborough Group in 1989 to offer education, advice and allocation management to corporate employees.

Our signature Savings Plan Management℠ service gives people the peace of mind that their retirement savings are being prudently managed, with little effort on their part. We provide ongoing management of the 401(k) savings plan along with personal guidance and support from a professional Retirement Advisor. The dedicated Advisor becomes a personal financial trainer, answering questions about the savings plan, proactively updating clients about their account, and helping them plan for retirement fitness.

The company maintains an 'independent advisor' status, enabling us to avoid any potential conflict of interest with 401(k) plan providers, such as mutual fund companies and banks. The Scarborough Group is a registered investment adviser with the Securities and Exchange Commission (SEC). All Retirement Advisors are Investment Adviser Representatives with The Scarborough Group. The principal and advisors of The Scarborough Group are also separately registered representatives of, and offer securities through, Royal Alliance Associates, Inc., an independent registered broker-dealer, member NASD/SIPC.

History of 401(k) Education and Advice

There basically are three levels of help available to 401(k) participants. The basic level of help is termed 'education.' Companies have a fiduciary responsibility to educate their employees about investing in the 401(k) plan. For most companies, this consists of a Summary Plan Description and prospectuses for the options available within the plan. Unfortunately, "communicating" does not necessarily mean "educating."

The next level is 'advice.' Although perfectly legal under certain conditions, companies, especially large ones, avoid giving specific investment recommendations to

[11] Additional information about the Conversation can be found at *www.pensioncoverage.net*.

employees for fear of lawsuits if the investment were to lose money. In this 'advice' category, some companies are implementing Internet-based advisory services.

However, its efficacy is still in question.

The final level is being termed 'managed accounts,' although we have called it Savings Plan Management℠ for almost thirteen years. A managed account provides an employee with professional management for their 401(k); similar to the professional management an employee would get with a pension (defined benefit) plan. This level of service can help employees prudently allocate their 401(k) investments with little knowledge and effort on their part. The Department of Labor recently issued an advisory opinion favorably reviewing 'managed accounts' as an option for 401(k) participants.

The Problems

The Scarborough Group has always warned plan participants about the dangers of overweighing your retirement account in a single stock issue. When lawsuits were brought against Lucent Technologies, we were hopeful that the issue was finally going to be addressed. Unfortunately for thousands of Enron participants, this warning went unnoticed.

The problems in defined contribution plans today can be linked to participant behavior and plan design.

Participant Behavior— In the wake of Enron it is easy for everyone to simply lay blame at the feet of the human resource and benefits personnel at the company for not addressing the issue of stock in their plan. However, participant behavior does play a major role also.

Look back on the rapid growth of the economy during the mid—to late-nineties; it is evident that participants were smitten by the idea of making huge returns in their plans through technology funds and company stock. In order to capitalize on the opportunity, they seriously overweighed their plan in single stock issues or investments that did not fit their investor profile and risk tolerance. When the market slipped into the recession, participants failed to divest out of the stock or did not rebalance their accounts. Huge losses were inevitable.

To better explain the mistakes participants make within their retirement plan, The Scarborough Group has identified the *Seven Sins of Participant Behavior*. They are:

- *Greed*—The desire for wealth, quickly and recklessly. Often causes participants to overweight the hot sector of the day. Company stock is often misused.
- *Panic*—Reacting without thought in an untimely fashion. Participants fall into the trap of either timing the market or locking in their losses when they react poorly to short-term events.
- *Conformity*—Following along with others. Participants will invest as they hear others investing, without regard for their personal situation.
- *Naiveté*—Not knowing, usually from lack of experience or education, the benefits and methods of properly investing in the savings plan options.
- *Apathy*—Lack of interest, indifference that causes employees to avoid education programs and/or not participate in the savings plan.
- *Arrogance*—Participants believe they know more than they actually do. They avoid education because they 'already know it all.'
- *Passivity*—Not active. Participants tend to rarely change their allocations from their first day of participation in the savings plan even though their personal situations have changed.

While seemingly beyond a plan sponsor's control, participants who exhibit these behaviors may not only fall short of their savings goals, but also could potentially represent a future liability.

A recent Watson Wyatt analysis of Defined Benefit and 401(k) Performance concluded that if employee-investors fall significantly behind, employers could expect that employees may eventually complain that either the funds or the education offered were inappropriate or insufficient.

Plan Design—Plan design can also be a culprit.

UCLA Accounting Professor Shlomo Benartzi has found that participants will place an inordinate amount of discretionary dollars into company stock when their non-discretionary company match is in stock.

Benartzi found that in plans that match with stock, 48% of all plan assets were in stock. Conversely, for companies that match contributions in cash, only 25% of the assets were in stock. Benartzi stated in the January 2001 issue of ***IOMA's DC Plan Investing,*** "—that employees interpret stock matches as an endorsement or as implicit investment advice."

The Solutions

How to resolve some of the issues affecting 401(k) plans, participants, and plan sponsors is currently being debated in the halls of congress, in our courtrooms, in the media, and in company lunchrooms.

Legislation—Since the collapse of Enron, and the subsequent collapse of 401(k) accounts, congressional and senate leaders have been introducing legislation at a break-neck pace. A number of the proposed initiatives only skirt the problems while other measures don't address the important issues at all.

As congressional leaders deliberate proposed legislation, it would be wise to simply eliminate all measures that place limits on how much company stock you can hold in your 401(k) account. We believe it is not the role of our government to determine where an investor can and cannot invest the discretionary dollars in their retirement plan. By prohibiting how much stock an investor may hold, our government could potentially set the stage for other problems.

Other measures the government should avoid considering, include any that lead to conflicted or biased advice; policies that force participants to hold stock for long periods of time; and proposals that allow companies to dictate how a participant's discretionary contributions are made.

We have a vision for what our government leaders can do to help prevent similar situations in the future. We recommend a 90-day holding limit on stock received through a company match; the encouragement of plan sponsors and plan providers to partner with *independent* advice providers; and the passage of legislation which will permit participants to hire an independent retirement planner on a pre-tax basis.

The DOL Advisory Opinion—The idea of "managed accounts" as a service for 401(k) participants has resonated throughout the Defined Contribution industry.

In response to an application by SunAmerica for a Prohibitive Transaction Exemption (PTE) in 2001, the Department of Labor responded with a landmark Advisory Opinion (2001–90A ERISA Sec. 406(b)), which affirms that companies are permitted to hire a licensed, independent adviser to provide advice and active management to individuals participating in 401(k) accounts.

Conclusion

America's future retirees are crying out for help. The suffering of plan participants at Enron and Lucent Technologies, is being felt by participants across the country. More than ever, people are asking themselves, "Will today be the day when my retirement disappears because of poor decision making by me or my employer?" The more it is discussed in congress, in the media, and in the lunchrooms, the more concerned participants become.

A major concern we have at The Scarborough Group is that legislators seem to be more concerned about how their decisions will impact the plan sponsors and plan providers and not the participants who seem to be distressed. Our government leaders and those in the media should be talking with those whose voice *is not* being heard in this debate—the voice of the participants.

Statement of Debbie Davis-Campbell, Wal-Mart Stores, Inc., Bentonville, Arkansas

Introduction

Mr. Chairman and Members of the Subcommittee, my name is Debbie Davis-Campbell and I am Vice President for Retirement and Savings Plans for Wal-Mart Stores, Inc. in Bentonville, Arkansas. Wal-Mart is pleased to have been invited by the Subcommittee to testify, and I regret that scheduling conflicts will prevent me from addressing you in person. Wal-Mart thanks the Subcommittee for the invitation to submit this written testimony on the important subject of employee retirement security.

Wal-Mart Stores, Inc. operates more than 2,740 discount stores, Supercenters and Neighborhood Markets, and more than 500 Sam's Clubs in the United States. Internationally, the company operates more than 1,170 units. Wal-Mart's annual sales last year were $218 billion. Wal-Mart employs 1.3 million associates worldwide. Fortune magazine has named Wal-Mart the third "most admired" company in America and one of the 100 best companies to work for in the United States. Last year Wal-Mart associates raised and contributed nearly $200 million to support communities and local non-profit organizations. More information about Wal-Mart can be located on-line at www.walmartstores.com and www.walmart.com.

Wal-Mart takes great pride in the benefits package it offers its associates, including two qualified retirement plans—The Wal-Mart Stores, Inc. Profit-Sharing Plan (the "Profit-Sharing Plan") and the Wal-Mart Stores, Inc. 401(k) Retirement Savings Plan (the "401(k) Plan"). The Profit-Sharing Plan is an employee stock ownership plan (an "ESOP") that invests primarily in Wal-Mart stock. The 401(k) Plan offers fourteen investment choices, one of which is Wal-Mart stock. Our retirement plans are an integral component of our associates' compensation and benefits package and an important part of their families' long-term financial security.

Wal-Mart and its associates hope that recent events will not impede the ability of companies like Wal-Mart to offer employer stock to its associates as a component in its retirement plans. Wal-Mart believes that its retirement plans strongly reflect its culture and its values—Wal-Mart has always sought to foster ownership by the people who make the company's success possible and Wal-Mart trusts its associates to make the decisions that are right for them. As you will see from the discussion below, these principles have served Wal-Mart and its retirement plans well for the past thirty years. While we fully appreciate the need for Congressional oversight in the wake of the Enron collapse, we hope that Wal-Mart's ability to continue to promote these principles will not be impaired.

I would first like to describe Wal-Mart's Profit-Sharing and 401(k) Plans to the Subcommittee, and then share some of Wal-Mart's thoughts on the pension reform proposals currently under consideration.

WAL–MART STORES INC. QUALIFIED RETIREMENT PLANS

Wal-Mart Stores, Inc. Profit-Sharing Plan

The Profit-Sharing Plan was established in 1971 by Wal-Mart's founder, Sam Walton. Mr. Walton very much believed, and the current leadership of Wal-Mart believes today, that the people who make a company's success possible—its associates—should share financially in that success. Towards this end, Mr. Walton established the Profit-Sharing Plan to allow associates to share in the success and to make associates partners in the business. Since its inception, Wal-Mart has always thought of the Profit-Sharing Plan as both a retirement vehicle and an ownership vehicle for its associates.

Although in 1971 the acronym "ESOP" had not yet been coined, the Wal-Mart Profit-Sharing Plan is an employee stock ownership plan, within the meaning of the Internal Revenue Code (the "Code"). An ESOP is different than a non-ESOP profit-sharing plan because it is expressly designed and intended to invest primarily in the stock of the employer. The Code subjects ESOPs to certain requirements different than those generally applicable to profit-sharing plans—including diversification requirements and requirements that participants in an ESOP be given an opportunity to vote their shares under the same conditions as non-ESOP shareholders. In other respects, however, an ESOP resembles a regular profit-sharing plan in that participants have individual accounts under the ESOP to which employer contributions are allocated.

Wal-Mart makes an annual cash contribution to the Profit-Sharing Plan based on the profitability of the company that year. Consistent with its status as an ESOP, most of the Profit-Sharing Plan's assets are invested in Wal-Mart stock. The Profit-Sharing Plan is governed by a committee that makes the decisions regarding the administration of the Plan and the investment of Plan assets.

Associates become participants in the Profit-Sharing Plan after completing one year of employment with Wal-Mart during which they complete 1,000 hours of service. The 1,000 hours threshold permits a significant number of our part-time associates to participate in the Plan as well. The Profit-Sharing Plan is funded entirely through company contributions. At retirement, participants in an ESOP have the right to receive their account distribution in the form of Wal-Mart stock or cash.

As noted above, the Code imposes certain diversification requirements on ESOPs so that participants who are nearing retirement age will have the opportunity to move some portion of their account balance into other investments. The Code generally requires ESOP participants who are 55 years old or older and who have ten years of service with the employer to be given the opportunity to invest a portion of their ESOP accounts in other investments. Wal-Mart has chosen to go beyond the diversification requirements in the Code and permit any associate with ten years of service with Wal-Mart (regardless of the age of the associate) to elect to diversify all or a portion of his or her Profit-Sharing Plan account by investing in an alternate investment.

The Profit-Sharing Plan has been a tremendous success story for Wal-Mart. It has provided retirement savings for thousands of Wal-Mart associates. Many long-term associates were able to retire with more savings than they ever dreamed possible

due to the steady appreciation of Wal-Mart stock over the years. Further, Wal-Mart firmly believes that the Profit-Sharing Plan is not just a retirement plan (although it has been extremely successful as a retirement plan), but is also an important reflection of Wal-Mart's corporate culture. Wal-Mart believes that broad-based employee ownership promotes productivity and stability and benefits both the company and our associates.

Wal-Mart Stores, Inc. 401(k) Retirement Savings Plan

Wal-Mart established the 401(k) Plan in response to an outpouring of comments from associates that they wanted an opportunity to invest their own money in a qualified retirement plan. As noted above, the Profit-Sharing Plan involves only company contributions. Wal-Mart responded by establishing the 401(k) Plan, which has approximately 650,000 participants.

Notably, and unlike many 401(k) plans, Wal-Mart makes an annual cash contribution to all eligible associates' 401(k) Plan accounts *regardless* of whether the associate has chosen to defer any portion of his or her salary to the 401(k) Plan. In other words, Wal-Mart's contribution is not a matching contribution, contingent on the associate's election to defer a portion of salary, but a contribution made to the Plan on behalf of each eligible associate. Like the Profit-Sharing Plan, associates become participants in the 401(k) Plan after one year of service with Wal-Mart in which they complete 1,000 hours of service. Also, an associate is *immediately* fully "vested" in his or her entire 401(k) account, meaning that no part of the 401(k) account will be forfeited if the associate leaves employment with Wal-Mart.

Unlike the Profit-Sharing Plan, associates direct the investment of their account, both Wal-Mart's cash contribution and amounts deferred by the associate, under the 401(k) Plan. The 401(k) Plan offers a menu of fourteen investment options. One of those fourteen options is Wal-Mart stock. There are no barriers of any type in the 401(k) Plan to buying and selling Wal-Mart stock and associates are subject to no restrictions regarding how long they must hold Wal-Mart stock. If an associate does not make an investment election, his or her account is by default invested in a balanced fund, which consists of diversified stock funds, a bond fund, and a stable value fund. There is no Wal-Mart stock in the balanced fund.

The 401(k) Plan answered the pleas of associates who wished to have the opportunity to invest their own money in a tax-qualified retirement plan. Our associates have clearly taken advantage of the 401(k) Plan to diversify their retirement plan assets and have done so without any legal requirements or regulations mandating that they do so. Wal-Mart believes firmly that associates should be provided with accurate, comprehensive information about their investment choices under the 401(k) Plan and then allowed to make the decisions that best suit the associate's individual investment needs.

PENSION REFORM PROPOSALS

Given the magnitude of the losses suffered by former Enron employees, Wal-Mart certainly understands the Subcommittee's and the Congress's desire to take action to ensure that such a situation does not occur again. Wal-Mart does not believe, however, that extensive pension reform is necessary, nor is it an effective solution to the problems presented by recent events. The defined contribution pension system generally works well, and the existing system of statutes and regulations protects the interests of plan participants without creating unduly onerous burdens on plan sponsors. As the Subcommittee is aware, it is extremely important, in our voluntary pension system, to be cognizant of this balance and avoid creating an atmosphere in which employers can no longer afford to sponsor retirement plans. Wal-Mart, like most plan sponsors, would welcome any reform that strengthens and improves the private pension system, but we fear that many of the current proposals would have unintended consequences or create burdens on plan administrators far in excess of the protections conferred on plan participants.

Below we discuss the current slate of pension reform proposals, identifying three topics common to most of the proposals. We hope to familiarize the Subcommittee with the implications such proposals would have for Wal-Mart's retirement plans and the ways in which current law may already address the concerns the proposed legislation seeks to remedy.

Percentage Caps on Employer Stock

At least two of the current bills propose setting a cap on the amount of employer stock that may be held in a participant's account—a Senate bill proposing a 20% cap and a House bill proposing a 10% cap. The Senate Bill excludes ESOPs from such limits, but the House bill does not. While Wal-Mart would oppose caps in any context, it would strenuously oppose the imposition of caps on an ESOP. To impose

percentage caps on ESOPs would effectively abolish ESOPs, the stated purpose of which is to invest in employer stock. As we discussed above, such a proposal would substantially hinder Wal-Mart and other companies for whom broad employee ownership is a critical component of both their employees' retirement savings and their corporate culture.

While Wal-Mart applauds Congress's desire to avert the sort of widespread employee losses that occurred in the wake of the Enron collapse, Wal-Mart believes that caps on employer stock are not the most effective way to do so. Wal-Mart is concerned that imposing caps on the amount employer of stock would have two, probably unintended, consequences that may actually undermine the intent of the sponsors of these provisions—they would limit employees' choice and control over their retirement assets and increase administrative costs.

Wal-Mart is concerned that imposing a "one-size-fits-all" percentage cap on the amount of employer stock that may be held in a participant's account unduly limits participant investment choice. With full disclosure and transparent financial information, there is no reason why 401(k) plan participants should not be trusted to make the right choices for themselves with respect to investments in employer stock. At Wal-Mart, every 401(k) Plan participant is different, facing different financial circumstances and a different investment timeline. We want to be able to offer those plan participants who choose to invest in Wal-Mart stock the free and unfettered ability to do so, without caps on the amount of employer stock that may not well suit the associates' particular investment desires or needs.

In addition, Wal-Mart is concerned that percentage limit would increase plan sponsors' administrative costs. In order to implement a percentage limit on employer stock, employers would be required to track the percentage of each participant's account that is invested in employer stock. This calculation would be complicated by daily fluctuations in the value of employer stock and in the market overall. Although this may not initially appear onerous, it would create new administrative costs for plan sponsors. Furthermore, it appears that a percentage cap on employer stock would force plan participants who exceeded the cap to sell some portion of their employer stock, perhaps at a time when they did not wish to do so or when doing so would be unfavorable to them.

While caps on employer stock may have diminished the magnitude of the Enron losses (although they certainly would not have prevented them), caps on employer stock also would have made many success stories impossible. Nor would percentage caps have served the interests of the hundreds of thousands of Americans, including thousands of Wal-Mart retirees, whose retirements were made more secure by wise and fair investments in their employers' stock.

Diversification Requirements

A second major theme in the current proposed pension reforms is the diversification of investments in employer stock. Most of these proposals would require plans to permit participants to transfer some or all of their investments in employer stock to other investments after being held for a certain period of time—anywhere from 90 days to three years. Some of these proposals also seek to change the diversification requirements applicable to ESOPs.

The proposed diversification requirements would not affect Wal-Mart's 401(k) Plan because it permits participants to trade Wal-Mart stock freely at any time. As noted above, Wal-Mart does not contribute any company stock to the 401(k) Plan, only cash. With respect to the Profit-Sharing Plan (which is an ESOP), however, Wal-Mart would strenuously oppose certain of the proposed changes in the diversification requirements applicable to ESOPs. As mentioned above, Wal-Mart provides more generous diversification options under the Profit-Sharing Plan than the Code requires. Any participant with ten years of service, regardless of age, is given the opportunity to diversify all or a portion of his or her Profit-Sharing Plan account. One current legislative proposal is to permit diversification in an ESOP with five years of service and 35 years of age.

A participant is not likely to have amassed a large balance at only five years of service under most circumstances, and thus the need to diversify would not yet be as pressing. Wal-Mart fears that a provision requiring diversification at five years of service would cause it to incur significant administrative expenses without providing meaningful diversification benefits to participants. Also, as discussed above, the very objective of an ESOP is to provide employees with long-term ownership in the employer. If Congress decides that new ESOP diversification requirements are necessary, Wal-Mart hopes that such provisions are considered carefully so that the diversification requirements do not create administrative costs disproportionate to the diversification benefits offered.

“Lockdown” Periods

Several of the current pension reform proposals also address so-called “lockdown” or “blackout” periods. These terms typically refer to the routine practice of suspending all transactions in a plan while the plan changes recordkeepers or other administrative service providers. Wal-Mart has never experienced a lockdown period because we have never had a need to change recordkeepers or otherwise restructure our plans in ways that would require the suspension of transactions. Nevertheless, Wal-Mart urges Congress to proceed cautiously in imposing new requirements on the administration of lockdown periods.

Several of the current legislative proposals mandate a notice period of a specified duration prior to a lockdown period. Wal-Mart agrees that mandated notice periods are sensible because plan participants should be given as much notice as possible prior to a suspension of transactions in their retirement plans. Wal-Mart questions, however, whether certain other proposed reforms—such as requiring Department of Labor approval prior to a lockdown—would provide meaningful benefits to plan participants. Although Wal-Mart has never had a lockdown period, we would want to be able to administer a lockdown period (if, for example, it became in our associates’ interest to change recordkeepers or otherwise reorganize the Plans) without undue cost and administrative burden. Congress should be aware of the costs and administrative burdens created by proposed reforms to ensure that they do not deter plan sponsors from changing recordkeepers when it may be beneficial to plan participants to do so.

CONCLUSION

In closing, Wal-Mart wishes to again thank the Subcommittee for the invitation to submit this written testimony on these important issues. We understand the desire of the Subcommittee and the Congress to ensure that there are effective protections in place for retirement plan participants. Wal-Mart urges the Congress, however, to consider carefully the effect pension reform legislation will have on the vast majority of employer-sponsored retirement plans that use employer stock as one component in their retirement plans. For these plans, many of the current proposals will limit employee choice and flexibility and increase the costs and burdens of plan administration. Rather, in the wake of Enron, Congress should focus its efforts on ensuring that all investors, including employees investing through company retirement plans, have easy access to full, accurate and transparent information about the company’s financial standing.

Wal-Mart is an example of just what an important role employer stock can play in an employee’s overall retirement portfolio. We are very proud of our retirement plans and their successful track records of providing our associates with secure retirements. We urge the Subcommittee and the Congress to avoid reforms that would jeopardize this success.