PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1978

HEARING

BEFORE THE

SUBCOMMITTEE ON LABOR STANDARDS

OF THE

COMMITTEE ON EDUCATION AND LABOR

HOUSE OF REPRESENTATIVES

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

H.R. 14138

TO PROVIDE FOR PENSION REFORM FOR STATE AND LOCAL PUBLIC EMPLOYEE RETIREMENT SYSTEMS, TO AMEND THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 TO PROMOTE MORE EFFICIENT AND SATISFACTORY MANAGEMENT OF THE FUNCTIONS OF THE FEDERAL GOVERNMENT RELATING TO EMPLOYEE PENSION AND WELFARE BENEFIT PLANS AND MORE EFFECTIVELY CARRY OUT THE PURPOSES OF SUCH ACT, AND FOR OTHER PURPOSES

HEARING HELD IN WHEATON, ILL., ON NOVEMBER 15, 1978

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PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1978

WEDNESDAY, NOVEMBER 15, 1978

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON LABOR STANDARDS (PENSION TASK FORCE) OF THE COMMITTEE ON EDUCATION AND LABOR,
Wheaton, Ill.

The subcommittee met, pursuant to notice, at 10 a.m. at DuPage Center, County Farm Road, Wheaton, Ill., Hon. Paul Simon presiding.

Members present: Representatives Simon and Erlenborn.

Staff present: S. Howard Kline, Esq., consultant, Pension Task Force, Drinker, Biddle & Reath, Philadelphia, Pa.; Russell J. Mueller, actuary and minority legislative associate, Pension Task Force; Barbara Mehlsack, associate counsel, Committee on Education and Labor.

Mr. SIMON. We will call the hearing to order, of the Subcommittee on Labor Standards and Pension Task Force.

If I may personally reflect, I have not been in my colleague Congressman Erlenborn's county for some time. I have never seen all these facilities. It is quite a change. I could not help notice also in the Hall of Presidents in the circle downstairs the last President acknowledged is Richard Nixon. No one since that time has been able to make it.

Before I read a formal opening statement, I might say I have at the State level gotten involved somewhat in the pension field. When I misbehaved as a member of the State house of representatives, I was assigned to a committee that was called Personnel and Pensions. I don't know if that committee still exists or not.

But whatever I learned in this field, it was valuable for me to serve on that committee and find that our pension systems in Illinois were not funded adequately. I learned from our colleague, Noble Lee, now retired dean of John Marshall School of Law and an actuary. He was very patient with those of us who knew so little.

Mr. A. A. Weinberg over and over gradually was able to impress this Member of Congress, then a member of the legislature, what was happening in this field.

I have always been grateful to Noble Lee and Al Weinberg since that time. It is good to see Mr. Weinberg here.

Today we open hearings on the Public Employee Retirement Income Security Act of 1978. We expect to have more hearings in the new Congress.

PERISA is directed toward bringing greater retirement security to more than 12 million participants and beneficiaries in the more

than 6,000 State and local government retirement systems. These retirement systems were excluded from the beneficial coverage of ERISA in 1974 because not enough was known about them.

In recognition of the need for a comprehensive body of information for use in considering Federal regulation of public plans, the drafters of ERISA mandated a study of these plans. The result of this mandate is the Pension Task Force Report on Public Employee Retirement Systems.

Here, if I may digress from my statement, great credit for both ERISA and PERISA must go to Congressman John Dent and my colleague, Congressman John Erlenborn, who have provided leadership in this area. Some of the rest of us have followed far behind in their leadership.

The Pension Task Force report identified the operational areas of public plans most in need of improvement and surveyed existing Federal and State regulations. What was discovered was something that many of us expected: Public plans are in need of additional Federal regulation, which should not be subjected to standards identical to ERISA.

In drafting PERISA, the draft report kept that very much in mind. Also kept in mind was the experience of private sector plans under ERISA. With PERISA, the hope is that we have created a workable and reasonable set of requirements that will not be unduly burdensome for plans to comply with.

PERISA protects the interest of public plan participants and beneficiaries through several means. Vitally important information regarding provisions and operation of plans is required to be provided in a timely manner to participants and beneficiaries.

Fiduciary standards are established requiring prudent operation of all aspects of a plan for the exclusive benefit of the participants and beneficiaries. Investing in employer securities is limited to 10 percent.

The current confusion regarding the applicability of Internal Revenue Code qualification procedures in public plans is removed.

Plans within the coverage of PERISA are to be considered tax qualified without regard to current requirements in the Internal Revenue Code.

The current multiagency administration of Federal law applicable to private and public plans is consolidated in a single agency, the Employee Benefit Administration.

[The text of H.R. 14138 follows:]

95TH CONGRESS
2D SESSION

H. R. 14138

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 20, 1978

Mr. DENT (for himself and Mr. ERLENBORN) introduced the following bill; which was referred jointly to the Committees on Education and Labor and Ways and Means

A BILL

To provide for pension reform for State and local public employee retirement systems, to amend the Employee Retirement Income Security Act of 1974 to promote more efficient and satisfactory management of the functions of the Federal Government relating to employee pension and welfare benefit plans and more effectively carry out the purposes of such Act, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLES AND TABLE OF CONTENTS

SECTION 1. Title I of this Act may be cited as the "Public Employee Retirement Income Security Act of 1978". Title II of this Act may be cited as the "Employee Benefit Administration Act of 1978".

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TITLE I—PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY

Subtitle A—General Provisions

FINDINGS AND DECLARATION OF POLICY

SEC. 2. (a) The Congress finds that the growth in size, scope, and numbers of employee pension benefit plans in recent years has been rapid and substantial; that the operational scope and economic impact of such plans is increasingly interstate; that the continued well-being and security of millions of employees and their dependents are directly affected by these plans; that they are affected with a national public interest; that they have become an important factor affecting the stability of employment; that they have become an important factor in commerce because of the interstate character of their activities, and of the activities of

their participants, and the employers, employee organizations, and other entities by which they are established or maintained; that the markets for securities which are subject to Federal regulation are substantially influenced by such plans; that a large volume of the activities of such plans is carried on by means of the mails and instrumentalities of interstate commerce; that many such plans have increasingly relied on Federal funds to meet the costs of such plans; that the interests which participants acquire in plans is in the nature of a property right; that these property rights are diminished in value because of inadequate safeguarding of plan assets and inadequate disclosure to participants of information relating to such plans; that plan participants are denied the equal protection of the laws by arbitrary resolution of applications for benefit payments; and that owing to the lack of employee information and adequate safeguards concerning their operation, it is desirable in the interests of employees and their beneficiaries, and to provide for the general welfare and the free flow of commerce, that disclosure be made and safeguards be provided with respect to the establishment, operation, and administration of such plans.

(b) It is hereby declared to be the policy of this Act to protect interstate commerce and the interests of participants in employee pension benefit plans and their beneficiaries, to minimize possible adverse impact on Federal

expenditures, to prevent deprivations by State and local governments of plan participants' property rights in employee pension benefit plans without due process of law, and to prevent denials by State and local governments of equal protection of the laws to plan participants, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee pension benefit plans, and by providing for appropriate remedies, sanctions, and ready access to Federal courts.

DEFINITIONS

SEC. 3. For purposes of this title—

(1) The terms "employee pension benefit plan" and "plan" mean any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program—

(A) provides retirement income to employees, or

(B) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond,

regardless of the method of calculating the contributions

made to the plan, the method of calculating the benefits under the plan, or the method of distributing benefits from the plan.

(2) The term "employee organization" means any labor union or any organization of any kind, or any agency or employee representation committee, association, group, or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning an employee pension benefit plan, or other matters incidental to employment relationships; or any employees' beneficiary association organized for the purpose, in whole or in part, of establishing such a plan.

(3) The term "employer" means the government of any State or political subdivision thereof, or any agency or instrumentality of a State or political subdivision thereof, or any person, acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee pension benefit plan; and includes a group or association of employers acting for an employer in such capacity.

(4) The term "employee" means any individual employed by an employer.

(5) The term "participant" means any employee

or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee pension benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.

(6) The term "beneficiary" means a person designated by a participant, or by the terms of an employee pension benefit plan, who is or may become entitled to a benefit thereunder.

(7) The term "person" means a State or political subdivision thereof or any agency or instrumentality of a State or political subdivision, an individual, partnership, joint venture, corporation, mutual company, joint-stock company, trust, estate, unincorporated organization, association, or employee organization.

(8) The term "State" includes any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, Guam, Wake Island, and the Canal Zone. The term "United States" when used in the geographic sense means the States and the Outer Continental Shelf lands defined in the Outer Continental Shelf Lands Act (43 U.S.C. 1331-1343).

(9) The term "commerce" means trade, traffic, commerce, transportation, or communication between any State and any place outside thereof.

(10) The term "party in interest" means, as to an employee pension benefit plan—

(A) any fiduciary, counsel, or employees of such plans;

(B) a person providing services to such plan;

(C) an employer any of whose employees are covered by such plan;

(D) an employee organization any of whose members are covered by such plan;

(E) a relative (as defined in paragraph (11)) of any individual described in subparagraph (A) or (B); or

(F) an employee, officer, director (or an individual having powers or responsibilities similar to those of officers or directors) of a person described in subparagraph (B), (C), or (D), or of the employee pension benefit plan.

(11) The term "relative" means a brother, sister, spouse of a brother or sister, spouse, ancestor, lineal descendant, or spouse of a lineal descendant.

(12) (A) The term "administrator" means—

(i) the person specifically so designated by the

terms of the instrument or instruments under which the plan is operated;

(ii) if an administrator is not so designated, the plan sponsor; or

(iii) in the case of a plan for which an administrator is not designated and a plan sponsor cannot be identified, such other person as the Employee Benefit Administration may by regulation prescribe.

(B) The term "plan sponsor" means (i) the employer in the case of a plan established or maintained by a single employer, (ii) the employee organization in the case of a plan established or maintained by an employee organization, or (iii) in the case of a plan established or maintained by two or more employers or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties who establish or maintain the plan.

(13) The term "separate account" means an account established or maintained by an insurance company under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such accounts without regard to other income, gains, or losses of the insurance company.

(14) The term "adequate consideration" when used in part 2 means (A) in the case of a security for which there is a generally recognized market, either (i) the price of the security prevailing on a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934, or (ii) if the security is not traded on such a national securities exchange, a price not less favorable to the plan than the offering price for the security as established by the current bid and asked prices quoted by persons independent of the issuer and of any party in interest; and (B) in the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Employee Benefit Administration.

(15) The term "vested pension benefit" means an interest obtained by a participant or beneficiary in that part of an immediate or deferred benefit under a plan which arises from the participant's service and which is not conditional upon the participant's continued service for an employer any of whose employees are covered under the plan, and which has not been forfeited under the terms of the plan.

(16) The term "security" has the same meaning as such term has under section 2(1) of the Securities Act of 1933 (15 U.S.C. 77b(1)).

(17) (A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 205(c)(1)(B).

(B) If any money or other property of a plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940, such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a fiduciary or a party in interest as those terms are defined in this Act, except insofar as such investment company or its investment adviser or principal underwriter

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acts in connection with an employee pension benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

(18) The term "accumulated plan benefit" means—

(A) in the case of a defined benefit plan, that portion of a participant's retirement benefit that is attributable, pursuant to the terms of the plan and in accordance with regulations of the Administration, to the participant's period of credited service prior to the date of determination, or

(B) in the case of an individual account plan, the balance of the participant's account on the date of determination.

(19) The term "current value" means fair market value where available and otherwise the fair value as determined in good faith by a trustee or a named fiduciary (as defined in section 202 (a) (2)) pursuant to the terms of the plan and in accordance with regulations of the Administration, assuming an orderly liquidation at the time of such determination.

(20) The term "individual account plan" means a

plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

(21) The term "defined benefit plan" means a plan other than an individual account plan; except that a plan which is not an individual account plan and which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant shall, for the purposes of paragraph (18) of this section, be treated as an individual account plan to the extent benefits are based upon the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan.

(22) The term "actuarial present value" means the single amount as of a given valuation date that results from applying actuarial assumptions to an amount or series of amounts payable or receivable at various times. Such amount or amounts shall be adjusted where appropriate to reflect—

(A) expected changes from the valuation date to the date of expected payment or receipt by reason

of expected salary changes, cost of living adjustments, or other changes; and

(B) the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment or receipt.

(23) The term "actuarial valuation method" means a procedure, using actuarial assumptions, for measuring the expected value of plan benefits and assigning such value to time periods.

(24) The term "actuarial value of assets" means the value assigned by the actuary to the assets of a plan for the purposes of an actuarial valuation.

(25) The term "annual actuarial value" means that part of the actuarial present value of all future benefit payments and administrative expenses assigned to each year, or other period, under the actuarial valuation method used by the plan (excluding any amortization of the unfunded supplemental actuarial value).

(26) The term "supplemental actuarial value" means the actuarial present value of all future benefit payments and administrative expenses under a plan

reduced by the actuarial present value of all future annual actuarial values (including any participants' contributions) with respect to the participants included in the actuarial valuation of the plan.

(27) The term "unfunded supplemental actuarial value" means the excess of the supplemental actuarial value over the actuarial value of assets of a plan.

(28) The term "investment manager" means any fiduciary (other than a trustee or named fiduciary, as defined in section 202 (a) (2))—

(A) who has the power to manage, acquire, or dispose of any asset of a plan;

(B) who is (i) registered as an investment adviser under the Investment Advisers Act of 1940; (ii) is a bank, as defined in that Act; or (iii) is an insurance company qualified to perform services described in subparagraph (A) under the laws of more than one State; and

(C) has acknowledged in writing that he is a fiduciary with respect to the plan.

(29) The terms "plan year" and "fiscal year of the plan" mean with respect to a plan, the calendar, policy, or fiscal year on which the records of the plan are kept.

(30) The terms "Employee Benefit Administra-

tion" and "Administration" mean the Employee Benefit Administration established by section 3001 of the Employee Retirement Income Security Act of 1974.

(31) The term "Act" means title I of this Act.

COVERAGE

SEC. 4. (a) Except as provided in subsection (b), this Act shall apply to any employee pension benefit plan.

(b) The provisions of this Act shall not apply to any employee pension benefit plan if such plan—

(1) is an employee benefit plan described in section 4(a) of the Employee Retirement Income Security Act of 1974, which is not exempt under section 4(b)(1) of such Act;

(2) is a plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees;

(3) is a severance pay plan, as defined in regulations by the Administration;

(4) is a coverage agreement entered into pursuant to section 218 of the Social Security Act;

(5) is an individual retirement account or an individual retirement annuity within the meaning of section 408, or a retirement bond within the meaning of section 409, of the Internal Revenue Code of 1954;

(6) is a plan described in section 401(d) of such Code;

(7) is an individual account plan consisting of an annuity contract described in section 403(b) of such Code;

(8) is a public employee deferred compensation plan set forth in the private letter ruling issued by the Internal Revenue Service on January 17, 1977, to the State of Louisiana Deferred Compensation Commission with respect to the State of Louisiana Deferred Compensation Plan for State Employees; or

(9) is a governmental plan described in the second sentence of section 3(32) of the Employee Retirement Income Security Act of 1974.

Subtitle B—Regulatory Provisions

Part 1—Reporting and Disclosure

duty of disclosure and reporting

SEC. 101. (a) Not more than 120 days after the establishment of the Administration, each plan administrator shall submit a registration statement to the Administration. Such registration statement shall provide the name and address of the plan and plan administrator, and such other information as to the characteristics and identity of the plan as the Administration deems necessary in order to determine the extent to which the provisions of section 109 should apply to such

plan. The Administration shall issue regulations to implement the provisions of this subsection.

(b) The administrator of each plan shall cause to be furnished the information described in sections 102, 104 (b) and (c), and 105 (a), (c), and (d), in the manner and to the extent provided in such sections.

(c) The administrator shall, in accordance with section 104 (a), file with the Administration—

(1) the summary plan description described in section 102 (a); and

(2) the annual report containing the information required by section 103.

SUMMARY PLAN DESCRIPTION

SEC. 102. (a) A summary plan description of any plan shall be furnished to participants and beneficiaries as provided in section 104 (b). The summary plan description shall include the information described in subsection (b), shall be written in a manner calculated to be understood by the average plan participant, and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of their rights and obligations under the plan. A summary of any material modification in the terms of the plan and any change in the information required under subsection (b) shall be written in a manner calculated to be

understood by the average plan participant and shall be furnished in accordance with section 104(b)(1).

(b) The summary plan description shall contain the following information: The name and type of administration of the plan; the name and address of the person designated as agent for the service of legal process, if such person is not the administrator; the name and address of the administrator; names, titles, and addresses of any trustee or trustees (if they are persons different from the administrator); a description of the relevant provisions of any applicable collective bargaining agreement; the plan's requirements respecting eligibility for participation and benefits; a description of the provisions providing for vested pension benefits; circumstances which may result in disqualification, ineligibility, or denial or loss of benefits; the source of financing of the plan and the identity of any organization through which benefits are provided; the date of the end of the plan year and whether the records of the plan are kept on a calendar, policy, or fiscal year basis; the procedures to be followed in presenting claims for benefits under the plan and the remedies available under the plan for the redress of claims which are denied in whole or in part (including procedures required under section 303 of this Act).

ANNUAL REPORT

SEC. 103. (a) (1) (A) An annual report shall be published with respect to every plan to which this part applies. Such report shall be filed with the Administration in accordance with section 104(a), and shall be made available and furnished to participants in accordance with section 104(b).

(B) The annual report shall include the information described in subsections (b) and (c), and where applicable subsections (d), (e), (f), (g), (h), and (i), and shall also include—

(i) a financial statement and opinion, as required by paragraph (3) of this subsection, and

(ii) an actuarial statement and opinion, as required by paragraph (4) of this subsection.

(2) If some or all of the information necessary to enable the administrator to comply with the requirements of this Act is maintained by—

(A) an insurance carrier or other organization which provides some or all of the benefits under the plan, or holds assets of the plan in a separate account,

(B) a bank or similar institution which holds some or all of the assets of the plan in a common or collective trust or a separate trust, or custodial account, or

(C) a plan sponsor as defined in section 3(12)(B).

such carrier, organization, bank, institution, or plan sponsor shall transmit and certify the accuracy of such information to the administrator within 120 days after the end of the plan year (or such other date as may be prescribed under regulations of the Administration).

(3) (A) Except as provided in subparagraph (C), the administrator of a plan shall engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an examination of any financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual report by subsection (b) of this section are presented fairly and in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards, except as provided in subparagraphs (B) and (C), and shall involve such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant. The independent qualified public accountant shall also offer his opinion as to whether the separate schedules specified in subsection (b) (2) of this section present fairly and in all material re-

spects the information contained therein when considered in conjunction with the financial statements taken as a whole. The opinion by the independent qualified public accountant shall be made a part of the annual report. In a case where a plan is not required to file an annual report, the requirements of this paragraph shall not apply. In a case where by reason of section 104 (a) (2) a plan is required only to file a simplified annual report, the Administration may modify or waive the requirements of this paragraph.

(B) In offering his opinion under this paragraph the accountant shall rely on the correctness of any actuarial matter certified to by an enrolled actuary.

(C) The opinion required by subparagraph (A) shall not be expressed as to any statements required by subsection (b) (2) (G) prepared by a bank or similar institution or insurance carrier regulated and supervised and subject to periodic examination by a State or Federal agency if such statements are certified by the bank, similar institution, or insurance carrier as accurate and are made a part of the annual report.

(D) For purposes of this Act, the term "qualified public accountant" means—

(i) a person who is a certified public accountant, certified by a regulatory authority of a State;

(ii) a person who is a licensed public accountant, licensed by a regulatory authority of a State; or

(iii) a person certified by the Administration as a qualified public accountant in accordance with regulations published by the Administration for a person who practices in States where there is no certification or licensing procedure for accountants.

(E) For purposes of this Act, the term "independent", when used in conjunction with qualified public accountant, shall be defined in regulations prescribed by the Administration.

(4) (A) The administrator of a plan subject to the reporting requirement of subsection (d) of this section shall engage, on behalf of all plan participants, an enrolled actuary who shall be responsible for the preparation of the materials comprising the actuarial statement required under subsection (d) of this section. In a case where a plan is not required to file an annual report, the requirements of this paragraph shall not apply.

(B) For purposes of this Act, the term "enrolled actuary" means an actuary enrolled under subtitle C of title III of the Employee Retirement Income Security Act of 1974.

(C) In making a certification under this section the enrolled actuary shall rely on the correctness of any

accounting matter under section 103(b) as to which any qualified public accountant has expressed an opinion.

(b) An annual report under this section shall include a financial statement containing the following information:

(1) A statement of assets and liabilities, and a statement of changes in net assets available for plan benefits which shall include details of revenues and expenses and other changes aggregated by general source and application. In the notes to financial statements, disclosures concerning the following items shall be considered by the accountant: a description of the plan including any significant changes in the plan made during the period and the impact of such changes on benefits; the funding policy (including policy with respect to prior service cost), and any changes in such policies during the year; a description of any significant changes in plan benefits made during the period; a description of material lease commitments, other commitments, and contingent liabilities; a description of agreements and transactions with persons known to be parties in interest; a general description of any plan provision providing for allocation of assets upon termination of the plan; information concerning whether or not a determination letter has been obtained from the Administration; and any other matters necessary to

fully and fairly present the financial statements of such pension plan.

(2) The following information in separate schedules relating to the statement required under paragraph (1):

(A) a statement of the assets and liabilities of the plan aggregated by categories and valued at their current value, and the same data displayed in comparative form for the end of the previous fiscal year of the plan;

(B) a statement of receipts and disbursements during the preceding twelve-month period aggregated by general sources and applications;

(C) a schedule of all assets held for investment purposes aggregated and identified by issuer, borrower, or lessor, or similar party to the transaction (including a notation as to whether such party is known to be a party in interest), maturity date, rate of interest, collateral, par or maturity value, cost, and current value;

(D) a schedule of each transaction (other than the payment of benefits pursuant to the terms of the plan) involving a person known to be party in interest, the identity of such party in interest and his relationship or that of any other party in interest to

the plan, a description of each asset to which the transaction relates; the purchase or selling price in the case of a sale or purchase, the rental in case of a lease, or the interest rate and maturity date in case of a loan; expenses incurred in connection with the transaction; the cost of the asset, the current value of the asset, and the net gain (or loss) on each transaction;

(E) a schedule of all loans or fixed income obligations which were in default as of the close of the plan's fiscal year or were classified during the year as uncollectable and the following information with respect to each loan on such schedule (including a notation as to whether parties involved are known to be parties in interest) : the original principal amount of the loan, the amount of principal and interest received during the reporting year, the unpaid balance, the identity and address of the obligor, a detailed description of the loan (including date of making and maturity, interest rate, the type and value of collateral, and other material terms), the amount of principal and interest overdue (if any) and an explanation thereof;

(F) a list of all leases which were in default or were classified during the year as uncollectable; and

the following information with respect to each lease on such schedule (including a notation as to whether parties involved are known to be parties in interest): the type of property leased (and, in the case of fixed assets such as land, buildings, leasehold, and so forth, the location of the property), the identity of the lessor or lessee from or to whom the plan is leasing, the relationship of such lessors and lessees, if any, to the plan, the employer, employee organization, or any other party in interest, the terms of the lease regarding rent, taxes, insurance, repairs, expenses, and renewal options; the date the leased property was purchased and its cost, the date the property was leased and its approximate value at such date, the gross rental receipts during the reporting period, expenses paid for the leased property during the reporting period, the net receipts from the lease, the amounts in arrears, and a statement as to what steps have been taken to collect amounts due or otherwise remedy the default;

(G) if some or all of the assets of a plan or plans are held in a common or collective trust maintained by a bank or similar institution or in a separate account maintained by an insurance carrier or a separate trust maintained by a bank as trustee, the

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report shall include the most recent annual statement of assets and liabilities of such common or collective trust, and in the case of a separate account or a separate trust, such other information as is required by the administrator in order to comply with this subsection.

The Administration may, by regulation, relieve any plan from filing a copy of a statement of assets and liabilities (or other information) described in subparagraph (G) if such statement or other information is filed with the Administration by a bank or similar institution or insurance carrier which maintains the common or collective trust, separate account, or separate trust.

(c) The administrator shall furnish as a part of a report under this section the following information:

(1) The number of employees covered by the plan.

(2) The name and address of each fiduciary.

(3) Except in the case of a person whose compensation is minimal (determined under regulations of the Administration) and who performs solely ministerial duties (determined under such regulations), the name of each person (including but not limited to any consultant, broker, trustee, attorney, accountant, insurance carrier, actuary, administrator, investment manager, or

custodian who rendered services to the plan or who had transactions with the plan) who received directly or indirectly compensation from the plan during the preceding year for services rendered to the plan or its participants, the amount of such compensation, the nature of his services to the plan or its participants, his relationship to the employer of the employees covered by the plan, or the employee organization, and any other office, position, or employment he holds with any party in interest.

(4) An explanation of the reason for any change in appointment of consultant, broker, trustee, attorney, accountant, insurance carrier, actuary, administrator, investment manager, or custodian.

(5) Such financial and actuarial information including but not limited to the material described in subsections (b) and (d) of this section as the Administration may find necessary or appropriate.

(d) With respect to a defined benefit plan (other than an insurance contract plan described in section 301(b) of the Employee Retirement Income Security Act of 1974), an annual report under this section shall include a complete actuarial statement applicable to the plan year which shall include the following:

(1) The date of the plan year, and the date of the actuarial valuation applicable to the plan year for which the report is filed.

(2) The amount of (A) the contributions made by the participants, and (B) all other contributions including those made by the employer or employers for the plan year for which the report is filed.

(3) The total estimated amount of the covered compensation with respect to active participants for the plan year for which the report is filed.

(4) The number of (A) active participants, (B) terminated participants eligible for deferred vested pension benefits or the return of contributions made by such participants, and (C) all other participants and beneficiaries included in the actuarial valuation.

(5) The following values as of the date of the actuarial valuation applicable to the plan year for which the report is filed: (A) the current value of plan assets, (B) the amount of accumulated mandatory contributions for active participants (including interest, if any), and (C) the amount of accumulated voluntary contributions for active participants (including interest, if any).

(6) The following information applicable to the plan year for which the report is filed: a description of the actuarial valuation method (including the actuarial

assumptions) or other basis on which the plan is funded, and if computed, the annual actuarial value, the supplemental actuarial value, and the unfunded supplemental actuarial value.

(7) The following actuarial values as of the date of the actuarial valuation applicable to the plan year for which the report is filed:

(A) the actuarial present value of all future plan benefits for the individuals described in subparagraphs (B) and (C) of paragraph (4);

(B) the actuarial present value of the total projected plan benefits for active participants (reflecting anticipated future increases in compensation and the cost of living, if applicable), allocated based on service to date;

(C) the actuarial present value of the total projected plan benefits for active participants (reflecting anticipated future increases in compensation and the cost of living, if applicable), allocated to future service;

(D) the actuarial present value of future covered compensation for active participants; and

(E) the actuarial value of assets.

The Administration may by regulation establish such additional subcategories under subparagraph (B) as it

may find appropriate and require that the portion of the value under subparagraph (C) attributable to participant contributions be shown separately. The enrolled actuary shall utilize such assumptions (on an explicit basis) and techniques as are necessary for the contents of the matters reported under this paragraph to be reasonably related to the experience of the plan and to reasonable expectations and to represent his best estimate of anticipated experience under the plan. The actuarial statement under this subsection shall include a description of the actuarial assumptions and techniques used to determine the actuarial values under this paragraph and shall disclose the impact of significant changes in the actuarial assumptions, plan provisions, and other pertinent factors on the actuarial position of the plan.

(8) A statement by the enrolled actuary that to the best of his knowledge the report under this subsection is complete and accurate and that in his opinion the assumptions and techniques utilized for purposes of paragraph (7) meet the requirements of such paragraph.

(9) Such other information as may be necessary to fully and fairly disclose the actuarial position of the

plan and any other information the enrolled actuary may present.

(10) Such other information regarding the plan as the Administration may by regulation require.

The enrolled actuary shall make an actuarial valuation of the plan for every third plan year, or more frequently if amendments to the plan are made which significantly affect the actuarial position of the plan or the enrolled actuary determines that a more frequent valuation is necessary to support his opinion under paragraph (8) of this subsection. A separate actuarial statement including all of the information required under this subsection shall be filed for each subpart of a plan which is determined in accordance with regulations of the Administration to be operated as a separate plan for funding purposes, such that the assets of the subpart cannot be used for the payment of benefits to persons not covered by such subpart.

(e) If some or all of the benefits under the plan are purchased from and guaranteed by an insurance company, insurance service, or other similar organization, a report under this section shall include a statement from such insurance company, service, or other similar organization covering the plan year and enumerating—

(1) the premium rate or subscription charge and

the total premium or subscription charges paid to each such carrier, insurance service, or other similar organization and the approximate number of persons covered by each class of such benefits; and

(2) the total amount of premiums received, the approximate number of persons covered by each class of benefits, and the total claims paid by such company, service, or other organization; dividends or retroactive rate adjustments, commissions, and administrative service or other fees or other specific acquisition costs paid by such company, service, or other organization; any amounts held to provide benefits after retirement; the remainder of such premiums; and the names and addresses of the brokers, agents, or other persons to whom commissions or fees were paid, the amount paid to each, and for what purpose. If any such company, service, or other organization does not maintain separate experience records covering the specific groups it serves, the report shall include in lieu of the information required by the foregoing provisions of this paragraph (A) a statement as to the basis of its premium rate or subscription charge, the total amount of premiums or subscription charges received from the plan, and a copy of the financial report of the company, service, or other organization and

(B) if such company, service, or organization incurs specific costs in connection with the acquisition or retention of any particular plan or plans, a detailed statement of such costs.

(f) An annual report required under this section shall contain the summary description of modifications and changes described in section 102, if such summary description is required pursuant to section 104(b)(2) for the plan year for which such annual report is required.

(g) An annual report required under this section shall set forth—

(1) the name of the plan, and any change in the name of the plan;

(2) the name and address of the plan administrator, and any change in the name or address of the plan administrator;

(3) the name and taxpayer identifying number of each participant in the plan—

(A) who in the year preceding the plan year for which such annual report is filed, separated from service covered by the plan,

(B) who did not return to service covered by the plan by the end of the plan year for which such annual report is filed,

(C) who is entitled to a vested pension benefit under the plan or to the return of employee contributions, and

(D) with respect to whom benefits were not paid under the plan during such plan years;

(4) the nature, amount, and form of any benefits to which such participant described in paragraph (3) is entitled, including, but not limited to, the contributions made by such participant, if any, and interest on such contributions, if any; and

(5) such other information as the Administration may require to carry out the purposes of this Act.

At the time the annual report is filed, the plan administrator shall furnish evidence satisfactory to the Administration that he has complied with the requirement contained in section 105 (c).

(h) Each plan administrator required to file an annual report may include in such report a statement relating to any matter contained in the annual report.

(i) Each administrator of a plan shall, in accordance with regulations promulgated by the Administration, file such information as the Administration may consider necessary—

(A) when the plan terminates;

(B) when the plan consolidates or merges with another plan; and

(C) when a contributing employer withdraws from the plan.

FILING WITH EMPLOYEE BENEFIT ADMINISTRATION AND FURNISHING INFORMATION TO PARTICIPANTS

SEC. 104. (a) (1) The administrator of any plan subject to this part shall file with the Administration—

(A) the annual report for a plan year within 210 days after the close of such year (or within such time as may be required by regulations promulgated by the Administration); and

(B) a copy of the summary plan description at the time the annual report is filed, or such other time as established by the Administration in regulations.

The Administration shall make copies of such summary plan descriptions and annual reports available for inspection in the public document room of the Administration. The administrator shall also furnish to the Administration, upon request, any documents relating to the plan, including but not limited to the bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated.

(2) (A) With respect to annual reports required to be filed with the Administration under this part, the Administration shall by regulation prescribe simplified annual reports for any plan which covers less than 100 participants.

(B) Nothing contained in this paragraph shall preclude the Administration from revoking provisions for simplified reports for any such plan if it finds it necessary to do so in order to carry out the objective of this Act.

(3) The Administration may reject any filing under this section if it determines that—

(A) such filing is incomplete for purposes of this part; or

(B) there is any material qualification by an accountant or actuary contained in an opinion or statement submitted pursuant to section 103(a)(3)(A) or section 103(d)(8).

(4) If the Administration rejects a filing of a report under paragraph (3) and if a revised filing satisfactory to the Administration is not submitted within 45 days after it makes its determination under paragraph (3) to reject the filing, and if the Administration deems it in the best interest of the participants, it may take any one or more of the following actions:

(A) retain an independent qualified public accountant (as defined in section 103(a)(3)(D) and (E)) on behalf of the participants to perform an audit,

(B) retain an enrolled actuary (as defined in section 103(a)(4)(B) of this Act) on behalf of the plan participants, to prepare an actuarial report,

(C) bring a civil action for such legal or equitable relief as may be appropriate to enforce the provisions of this part, or

(D) take any other action authorized by this Act.

The administrator shall permit such accountant or actuary to make such inspection of the books and records of the plan as is necessary to conduct such audit or prepare such actuarial report. The plan shall be liable to the Administration for the expenses for such audit or actuarial report, and the Administration may bring an action against the plan in any court of competent jurisdiction to recover such expenses.

(b) Publication of the summary plan descriptions and annual reports shall be made to participants and beneficiaries of the particular plan as follows:

(1) The administrator shall furnish to each participant, and each beneficiary receiving benefits under the plan, a copy of the summary plan description, including all modifications and changes referred to in section 102 (a) a summary description of which has been furnished to other participants and beneficiaries—

(A) within one year and 90 days after he becomes a participant, or (in the case of a beneficiary) within 90 days after he first receives benefits, or

(B) if later, within one year and 90 days after the plan becomes subject to this part.

(2) The administrator shall, if there is a modification or change described in section 102(a), furnish a summary description of such modification or change to each participant, and to each beneficiary who is receiving benefits under the plan, whose future benefits can reasonably be expected to be affected thereby. The administrator shall furnish such summary description not later than 210 days after the end of the plan year in which the change is adopted, or within such time as the Administration may prescribe by regulation.

(3) The administrator shall furnish to each participant, and each beneficiary receiving benefits under the plan, whose future benefits can reasonably be expected to be affected thereby, at least once in every 10 years after the plan becomes subject to this part, an updated summary plan description described in section 102 which shall be updated by the integration into the summary plan description of all plan amendments, if any, made within such 10-year period.

(4) The administrator shall make copies of the latest annual report and the bargaining agreement, trust agreement, contract, or other instruments under which the plan was established or is operated available for

examination by any plan participant or beneficiary in the principal office of the administrator and in such other places as may be necessary to make available all pertinent information to all participants (including such places as the Administration may prescribe by regulations).

(5) The administrator shall, upon written request of any participant or beneficiary, furnish a copy of summary plan descriptions, annual reports, bargaining agreements, trust agreements, contracts, or other instruments under which the plan is established or operated. The administrator may make a reasonable charge to cover the cost of furnishing such complete copies. The Administration may by regulation prescribe the maximum amount which will constitute a reasonable charge under the preceding sentence.

(c) The Administration may by regulation require that the administrator of any plan furnish to each participant and to each beneficiary receiving benefits under the plan a statement of the rights of participants and beneficiaries under this Act. Any such statement shall be made part of the summary plan description described in section 102.

REPORTING OF PARTICIPANT'S BENEFIT RIGHTS

SEC. 105. (a) Each administrator of a plan shall furnish to any plan participant or beneficiary who so requests in writ-

ing, a statement indicating, on the basis of the latest available information—

(1) the total accumulated plan benefits, and the extent to which such benefits are or will become vested pension benefits, and, if applicable, the earliest date on which such accumulated plan benefits are expected to become vested pension benefits, and

(2) the total accumulated contributions made by the participant, including interest, if any, pursuant to the terms of the plan.

(b) In no case shall a participant or beneficiary be entitled under this section to receive more than one report described in subsection (a) during any one 12-month period. If an administrator furnishes an annual statement which contains the information described in subsection (a), the furnishing of such annual statement shall satisfy the requirements of subsection (a).

(c) Each plan administrator required to file an annual report containing the information described in section 103 (g) shall, before the expiration of the time prescribed for the filing of such annual report, also furnish to each participant described in section 103 (g) (3) an individual statement setting forth the information required to be filed under section 103 (g) (4).

(d) The administrator shall furnish to any participant or beneficiary who requests—

(1) the withdrawal of contributions made by a participant,

(2) the payment of any benefit from the plan, or

(3) in accordance with the terms of the plan, an election as to the form of benefits to be made available under the provisions of the plan,

a written explanation of the effect of such withdrawal, payment, or election on the remaining plan benefits of the participant or beneficiary. Such explanation shall include a description of the various alternative forms of benefit payments, if any, which the participant may elect. No such election shall be final until 14 days shall have elapsed from the date on which such explanation is furnished to the participant or beneficiary or, if earlier, the date any payment is made in accordance with such election. The Administration shall prescribe such regulations as may be necessary to carry out the provisions of this subsection.

REPORTS MADE PUBLIC INFORMATION

SEC. 106. (a) Except as provided in subsection (b), the contents of the descriptions, annual reports, statements, and other documents filed with the Administration pursuant to this part shall be public information and the Adminis-

tration shall make any such information and data available for inspection in the public document room of the Administration. The Administration and the Advisory Council on Governmental Plans may use the information and data for statistical and research purposes, and compile and publish such studies, analyses, reports, and surveys based thereon as they may deem appropriate.

(b) Information required to be furnished pursuant to section 105 (a) and (c) with respect to a participant may be disclosed by the Administration only to the extent that information respecting that participant's benefits under title II of the Social Security Act may be disclosed under such Act.

RETENTION OF RECORDS

SEC. 107. Every person who is subject to a requirement to file any description or report or to certify any information therefor under this Act or who would be subject to such a requirement but for an exemption under section 109 or simplified reporting requirement under section 104 (a) (2) of this Act shall maintain records on the matters of which disclosure is thus required or would have been required but for such an exemption or simplified reporting requirement which will provide in sufficient detail the necessary basic information and data from which the documents which are thus required or which would have been required but for such an exemption or simplified reporting require-

ment may be reconstructed, verified, explained, or clarified, and checked for accuracy and completeness, and shall include vouchers, worksheets, receipts, and applicable resolutions, and shall keep such records available for examination for a period of not less than six years after the filing date of the documents based on the information which they contain, or not less than six years after the date on which such documents would have been filed but for an exemption under section 109 or simplified reporting requirement under section 104(a)(2).

RELIANCE ON ADMINISTRATIVE INTERPRETATIONS

SEC. 108. In any criminal proceeding under section 211, 212, 301(a), or 311 based on any act or omission in alleged violation of this part or section 211, 212, or 311, no person shall be subject to any liability or punishment for or on account of the failure of such person to (1) comply with this part or section 211, 212, or 311, if he pleads and proves that the act or omission complained of was in good faith in conformity with, and in reliance on any regulation or written ruling of the Administration, or (2) publish and file any information required by any provision of this Act if he pleads and proves that he published and filed such information in good faith, and in conformity with any regulation or written ruling of the Administration issued under this Act regarding the

filing of such reports. Such a defense, if established, shall be a bar to the action or proceeding, notwithstanding that (A) after such act or omission, such interpretation or opinion is modified or rescinded or is determined by judicial authority to be invalid or of no legal effect, or (B) after publishing or filing the plan description, annual reports, and other reports required by this Act, such publication or filing is determined by judicial authority not to be in conformity with the requirements of this Act.

ALTERNATIVE METHODS OF COMPLIANCE

SEC. 109. (a) The Administration, on its own motion or after having received the petition of an administrator, may prescribe an alternative method for satisfying any requirement of this part or section 303 with respect to any plan, or class of plans, subject to such requirement if he determines—

(1) that the use of such alternative method is consistent with the purposes of this Act and that it provides adequate disclosure to the participants and beneficiaries in the plan, and adequate reporting to the Administration, and

(2) that the application of such requirement of this part would—

(A) increase the costs to the plan, or

(B) impose unreasonable administrative burdens with respect to the operation of the plan, having regard to the particular characteristics of the plan or the type of plan involved.

(b) An alternative method may be prescribed under subsection (a) by regulation or otherwise. If an alternative method is prescribed other than by regulation, the Administration shall provide notice and an opportunity for interested persons to present their views, and shall publish in the Federal Register the provisions of such alternative method.

(c) The Administration may by regulation exempt any plan or person, or any class of plans or persons, conditionally or unconditionally from any requirement of this part or section 202, 203, 212, or 303 if it determines, after giving full consideration to the use of alternative methods under subsections (a) and (b), that such exemption is—

(1) appropriate and necessary in the public interest, and

(2) consistent with the purposes of this Act.

(d) Before issuing any exemption or alternative method under this section, the Administration shall take into account any recommendations made by the Advisory Council on Governmental Plans.

FORMS

SEC. 110. (a) Except as required by subsection (b), the Administration may require that any information required under this part, including but not limited to the information required to be filed by the administrator pursuant to sections 103 (b) (2) and (c), shall be submitted on such forms as it may prescribe.

(b) The financial statement and opinion required to be prepared by an independent qualified public accountant pursuant to section 103 (a) (3) (A), the actuarial statement required to be prepared by an enrolled actuary pursuant to section 103 (a) (4) (A), the summary plan description described in section 102, and information submitted pursuant to sections 103 (f) and 103 (h), shall not be required to be submitted on forms.

(c) The Administration may prescribe the format and content of the summary plan description, and any other report, statements, or documents (other than the bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated), which are required to be furnished or made available to plan participants and beneficiaries under the plan.

(d) In order to avoid the reporting of unnecessary information and to prevent unreasonable administrative burdens

with respect to the operation of plans, the Administration shall develop reporting forms and requirements for plans which, to the maximum extent feasible and consistent with the purposes of this Act, take into account the different types and sizes of plans.

PART 2—FIDUCIARY RESPONSIBILITY

COVERAGE

SEC. 201. (a) This part shall apply to any plan described in section 4(a) (and not exempted under section 4(b)).

(b) For purposes of this part:

(1) In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such security but shall not, solely by reason of such investment, be deemed to include any assets of such investment company.

(2) In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer. For purposes of this paragraph:

(A) The term "insurer" means an insurance company, insurance service, or insurance organization, qualified to do business in a State.

(B) The term "guaranteed benefit policy" means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. Such term includes any surplus in a separate account, but excludes any other portion of a separate account.

ESTABLISHMENT OF PLAN

SEC. 202. (a) (1) Every plan shall be established and maintained pursuant to a written instrument or instruments. Such instrument or instruments shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan.

(2) For purposes of this Act, the term "named fiduciary" means a fiduciary who is named in a plan instrument or instruments, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary.

(b) Every plan shall—

(1) state whether a funding policy or goal has been established for the plan, and shall describe the

funding policy or goal, the method for carrying out such policy or goal, if any, and the source of funds,,

(2) describe any procedure under the plan for the allocation of responsibilities for the operation and administration of the plan (including any procedure described in section 205(b)(1)),

(3) provide a procedure for amending such plan, and for identifying the persons who have authority to amend the plan, unless the sole procedure for amending such plan is by legislation, and

(4) specify the plan provisions relating to benefits (including, but not limited to, eligibility, benefit levels, and the form and method of payment of benefits).

(c) Any plan may provide—

(1) that any person or group of persons may serve in more than one fiduciary capacity with respect to the plan (including service both as trustee and administrator);

(2) that a named fiduciary, or a fiduciary designated by a named fiduciary pursuant to a plan procedure described in section 205(b)(1), may employ one or more persons to render advice with regard to any responsibility such fiduciary has under the plan; or

(3) that a person who is a named fiduciary with

respect to control or management of the assets of the plan may appoint an investment manager or managers to manage (including the power to acquire and dispose of) any assets of a plan.

ESTABLISHMENT OF TRUST

SEC. 203. (a) Except as provided in subsection (b), all assets of a plan shall be held in trust by one or more trustees. Such trustee or trustees shall be either named in the trust instrument or in the plan instrument or instruments described in section 202 (a) or appointed by a person who is a named fiduciary, and upon acceptance of being named or appointed, the trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that—

(1) the plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, in which case the trustees shall be subject to proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to this Act, or

(2) authority to manage, acquire, or dispose of assets of the plan is delegated to one or more investment managers pursuant to section 202 (c) (3).

(b) The requirements of subsection (a) of this section shall not apply—

(1) to any assets of a plan which consist of insurance contracts or policies issued by an insurance company qualified to do business in a State; or

(2) to any assets of such an insurance company or any assets of a plan which are held by such an insurance company.

(c) (1) Except as provided in paragraph (2), the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

(2) In the case of a contribution which is made by an employer by a mistake of fact, paragraph (1) shall not prohibit the return of such contribution to the employer within one year after the plan administrator knows, or should know in the regular course of business, that the contribution was made by a mistake of fact.

FIDUCIARY DUTIES

SEC. 204. (a) Subject to section 203 (c) of this Act, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(1) for the exclusive purpose of—

(A) providing benefits to participants and their beneficiaries; and

(B) defraying reasonable expenses of administering the plan;

(2) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(3) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(4) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this Act.

(b) Except as authorized by the Administration by regulation, no fiduciary may maintain the indicia of ownership of any assets of a plan outside the jurisdiction of the district courts of the United States.

(c) In the case of a plan which provides for individual accounts and permits a participant or beneficiary to exercise control over assets in his account, if a participant or beneficiary exercises control over the assets in his account (as may be determined under regulations of the Administration)—

(1) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and

(2) no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control.

LIABILITY FOR BREACH BY CO-FIDUCIARY

SEC. 205. (a) In addition to any liability which he may have under any other provision of this part, a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:

(1) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;

(2) if, by his failure to comply with section 204 (a) in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or

(3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

(b) (1) Except as otherwise provided in subsection (d)

and in section 203 (a) (1) and (2), if the assets of a plan are held by two or more trustees—

(A) each shall use reasonable care to prevent a co-trustee from committing a breach; and

(B) they shall jointly manage and control the assets of the plan, except that nothing in this subparagraph shall preclude any agreement, authorized by the trust instrument, allocating specific responsibilities, obligations, or duties among trustees, in which event a trustee to whom certain responsibilities, obligations, or duties have not been allocated shall not be liable by reason of this paragraph either individually or as a trustee for any loss resulting to the plan arising from the acts or omissions on the part of another trustee to whom such responsibilities, obligations, or duties have been allocated.

(2) Nothing in this subsection shall limit any liability that a fiduciary may have under subsection (a) or any other provision of this part.

(3) (A) In the case of a plan the assets of which are held in more than one trust, a trustee shall not be liable under paragraph (1) except with respect to an act or omission of a trustee of a trust of which he is a trustee.

(B) No trustee shall be liable under this subsection for following instructions referred to in section 203 (a) (1).

(c) (1) The instrument or instruments under which a plan is maintained may expressly provide for procedures (A) for allocating fiduciary responsibilities (other than trustee responsibilities) among named fiduciaries, and (B) for named fiduciaries to designate persons other than named fiduciaries to carry out fiduciary responsibilities (other than trustee responsibilities) under the plan.

(2) If a plan expressly provides for a procedure described in paragraph (1), and pursuant to such procedure any fiduciary responsibility of a named fiduciary is allocated to any person, or a person is designated to carry out any such responsibility, then such named fiduciary shall not be liable for an act or omission of such person in carrying out such responsibility except to the extent that—

(A) the named fiduciary violated section 204 (a)—

(i) with respect to such allocation or designation,

(ii) with respect to the establishment or implementation of the procedure under paragraph (1), or

(iii) in continuing the allocation or designation; or

(B) the named fiduciary would otherwise be liable in accordance with subsection (a).

(3) For purposes of this subsection, the term "trustee responsibility" means any responsibility provided in the plan's trust instrument (if any) to manage or control the assets of the plan, other than a power under the trust instrument of a named fiduciary to appoint an investment manager in accordance with section 202(c)(3).

(d)(1) If an investment manager or managers have been appointed under section 202(c)(3), then, notwithstanding subsections (a)(2) and (3) and subsection (b), no trustee shall be liable for the acts or omissions of such investment manager or managers, or be under an obligation to invest or otherwise manage any asset of the plan which is subject to the management of such investment manager.

(2) Nothing in this subsection shall relieve any trustee of any liability under this part for any act of such trustee.

(e) As used in subsection (a)(3) the term "knowledge" means knowledge actually learned or communicated, or knowledge which, in the normal course of business, should have been learned or communicated.

PROHIBITED TRANSACTIONS

SEC. 206. (a) Except as provided in section 208, a fiduciary with respect to a plan shall not cause the plan to engage in a transaction if he knows or should know that such transaction constitutes a direct or indirect—

(1) sale or exchange, or leasing, of any property

from the plan to a party in interest for less than adequate consideration, or from a party in interest to a plan for more than adequate consideration;

(2) lending of money or other extension of credit from the plan to a party in interest without the receipt of adequate security and a reasonable rate of interest, or from a party in interest to a plan with the provision of excessive security or an unreasonably high rate of interest;

(3) furnishing of goods, services, or facilities from the plan to a party in interest for less than adequate consideration, or from a party in interest to a plan for more than adequate consideration;

(4) transfer to, or use by or for the benefit of, a party in interest of any assets of the plan for less than adequate consideration;

(5) acquisition, on behalf of the plan, of any employer security, employer real property, or employer loan, in violation of section 207 (a).

(b) A fiduciary with respect to a plan shall not—

(1) deal with the assets of the plan in his own interest or for his own account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are ad-

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verse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

10 PERCENT LIMITATION WITH RESPECT TO ACQUISITION OF EMPLOYER SECURITIES, OTHER EMPLOYER OBLIGATIONS, AND EMPLOYER REAL PROPERTY BY CERTAIN PLANS

SEC. 207. (a) (1) Except as otherwise provided in this section and section 214—

(A) a plan may not acquire—

(i) any employer security which is not a qualifying employer security,

(ii) any employer real property which is not qualifying employer real property, or

(iii) any employer loan (including any other extension of credit) which is not a qualifying employer loan, and

(B) a plan may not acquire any qualifying employer security, qualifying employer real property, or qualifying employer loan, if immediately after such acquisition the aggregate fair market value of employer securities, employer real property, and employer loans

held by the plan exceeds 10 percent of the fair market value of the assets of the plan.

(2) Notwithstanding paragraph (1) (B), a plan may acquire qualifying employer securities, qualifying employer real property, and qualifying employer loans if such acquisitions are made pursuant to a binding contractual obligation made prior to the date of the enactment of this Act.

(b) For purposes of this section—

(1) The term "employer security" means a security issued by an employer of employees covered by the plan, or by an affiliate of such employer.

(2) The term "qualifying employer security" means an employer security which is stock or a marketable obligation (as defined in subsection (c)).

(3) The term "employer real property" means real property (and related personal property) which is leased to an employer of employees covered by the plan, or to an affiliate of such employer. For purposes of determining the time at which a plan acquires employer real property for purposes of this section, such property shall be deemed to be acquired by the plan on the date on which the plan acquires the property or on the date on which the lease to the employer (or affiliate) is entered into, whichever is later.

(4) The term "qualifying employer real property" means parcels of employer real property—

(A) if each parcel of real property and the improvements thereon are suitable (or adaptable without excessive cost) for more than one use; and

(B) if the acquisition of such property complies with the provisions of this part (other than section 204(a)(2) to the extent it requires diversification, section 204(a)(3), section 206, and subsection (a) of this section).

(5) The term "employer loan" means a loan or other extension of credit, not otherwise described in paragraph (1), issued or otherwise entered into by an employer of employees covered by the plan, or by an affiliate of such employer. An employer's failure to make contributions when due, unless evidenced by a promissory note, shall not be deemed to be a loan or other extension of credit.

(6) The term "qualifying employer loan" means an employer loan which bears a reasonable rate of interest and is fully secured by marketable securities, or such other employer loan as defined under regulations issued by the Administration.

(7) The term "affiliate", when used in conjunction with an employer, means the government of a State or

political subdivision thereof, or any agency or instrumentality of such a State or political subdivision, located in the same State as such employer.

(c) For purposes of subsection (b) (2), the terms "marketable obligation" and "obligation" mean a bond, debenture, note, or certificate, or other evidence of indebtedness if—

(1) the obligation is acquired—

(A) on the market, either (i) at the price of the obligation prevailing on a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934, or (ii) if the obligation is not traded on such a national securities exchange, at a price not less favorable to the plan than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer;

(B) from an underwriter, at a price (i) not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular, and (ii) at which a substantial portion of the same issue is acquired by persons independent of the issuer; or

(C) directly from the issuer, at a price not less favorable to the plan than the price paid currently

for a substantial portion of the same issue by persons independent of the issuer; and

(2) immediately following acquisition of such obligation—

(A) not more than 25 percent of the aggregate amount of obligations issued in such issue and outstanding at the time of acquisition is held by the plan, and

(B) at least 50 percent of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer.

EXEMPTIONS FROM PROHIBITED TRANSACTIONS

SEC. 208. Nothing in section 206 shall be construed to prohibit any fiduciary from—

(1) receiving any benefit to which he may be entitled as a participant or beneficiary in the plan, or paying any benefit to any participant or beneficiary, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as generally applied to all participants and beneficiaries;

(2) receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan; or

(3) serving as a fiduciary in addition to being an

officer, employee, agent, or other representative of a party in interest.

LIABILITY FOR BREACH OF FIDUCIARY DUTY

SEC. 209. (a) Except as provided in subsection (c), any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries or co-fiduciaries by this Act shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 211 of this Act.

(b) No fiduciary shall be liable with respect to a breach of fiduciary or co-fiduciary duty under this Act if such breach was committed before he became a fiduciary or after he ceased to be a fiduciary.

(c) (1) Except as provided in paragraph (2), any fiduciary with respect to a plan who is an individual and—

(A) is an employee of or serves as an official of an employer any of whose employees are covered by such plan, or

(B) is employed by or serves as an official of an affiliate of such an employer (within the meaning of section 207(b)(7)),

shall not be personally liable to make good to such plan any losses to the plan resulting from such individual fiduciary's breach or breaches of any of the responsibilities, obligations, or duties imposed upon fiduciaries or co-fiduciaries by this Act, except to the extent that such losses would be recoverable under insurance or bonding described in sections 210 and 212, respectively, in the absence of this subsection.

(2) Paragraph (1) shall not apply to a fiduciary who is convicted in a criminal proceeding of a violation which is an element of the breach or breaches referred to in paragraph (1).

(3) For purposes of paragraph (2), a person shall be deemed to have been convicted from the date of the judgment of the trial court or the date of final sustaining of such judgment on appeal, whichever is the later event.

(d) (1) In the case of any loss to a plan for which any individual fiduciary would be liable but for the provisions of subsection (c)(1), the employer of the employee, the employer for which such individual serves as an official, or the affiliate for which such individual is employed or serves as an official, shall be liable to the plan for such loss.

(2) Nothing in this section shall prevent the recovery by an employer or an affiliate of an employer from an employee or official of amounts for which the employer or affiliate is liable under paragraph (1).

EXCULPATORY PROVISIONS; INSURANCE

SEC. 210. (a) Except as provided in sections 205(b), 205(d), and 209(c), any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under this part shall be void as against public policy.

(b) Nothing in this section shall preclude—

(1) a plan from purchasing insurance for its fiduciaries or for itself to cover liability or losses occurring by reason of the act or omission of a fiduciary, if such insurance permits recourse by the insurer against the fiduciary in the case of a breach of a fiduciary obligation by such fiduciary;

(2) a fiduciary from purchasing insurance to cover liability under this part from and for his own account; or

(3) an employer or an employee organization from purchasing insurance to cover potential liability of one or more persons or otherwise indemnify such persons who serve in a fiduciary capacity with regard to a plan.

PROHIBITION AGAINST CERTAIN PERSONS HOLDING CERTAIN POSITIONS

SEC. 211. (a) No person who has been convicted of, or has been imprisoned as a result of his conviction of, robbery, bribery, extortion, embezzlement, fraud, grand larceny, burglary, arson, a felony violation of Federal or State law involving substances defined in section 102(6) of the Comprehensive Drug Abuse Prevention and Control Act of 1970, murder, rape, kidnaping, perjury, assault with intent to kill, any crime described in section 9(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-9(a)(1)), a violation of any provision of this Act or the Employee Retirement Income Security Act of 1974, a violation of section 302 of the Labor-Management Relations Act of 1947 (29 U.S.C. 186), a violation of chapter 63 of title 18, United States Code, a violation of section 874, 1027, 1503, 1505, 1506, 1510, 1951, or 1954 of title 18, United States Code, a violation of the Labor-Management Reporting and Disclosure Act of 1959 (29 U.S.C. 401), or conspiracy to commit any such crimes or attempt to commit any such crimes, or a crime in which any of the foregoing crimes is an element, shall serve or be permitted to serve as an administrator, fiduciary, officer, trustee, custodian, counsel, agent, or consultant, with any plan during or for five years

after such conviction or after the end of such imprisonment, whichever is the later, unless prior to the end of such five-year period, in the case of a person so convicted or imprisoned, (A) his citizenship rights, having been revoked as a result of such conviction, have been fully restored, or (B) the Board of Parole of the United States Department of Justice determines that such person's service as an administrator, fiduciary, officer, trustee, custodian, counsel, agent, or consultant would not be contrary to the purposes of this Act. Prior to making any such determination the Board shall hold an administrative hearing and shall give notice of such proceeding by certified mail to the State, county, and Federal prosecuting officials in the jurisdiction or jurisdictions in which such person was convicted. The Board's determination in any such proceeding shall be final. No person shall knowingly permit any other person to serve as an administrator, fiduciary, officer, trustee, custodian, counsel, agent, or consultant in violation of this subsection. Notwithstanding the preceding provisions of this subsection, no corporation or partnership will be precluded from acting as an administrator, fiduciary, officer, trustee, custodian, counsel, agent, or consultant, of any plan without a notice, hearing, and determination by such Board of Parole that such service would be inconsistent with the intention of this section.

(b) Any person who intentionally violates this section shall be fined not more than $10,000 or imprisoned for not more than one year, or both.

(c) For the purposes of this section:

(1) A person shall be deemed to have been "convicted" and under the disability of "conviction" from the date of the judgment of the trial court or the date of the final sustaining of such judgment on appeal, whichever is the later event.

(2) The term "consultant" means any person who, for compensation, advises or represents a plan or who provides other assistance to such plan, concerning the establishment or operation of such plan.

(3) A period of parole shall not be considered as part of a period of imprisonment.

(d) Notwithstanding any provision of this section, no elected official shall be precluded from acting as a fiduciary by reason of official duties because of any conviction described in subsection (a).

BONDING

SEC. 212. (a) Every fiduciary of a plan and every person who handles funds or other property of such a plan (hereinafter in this section referred to as "plan official") shall be bonded as provided in this section; except that—

(1) where such plan is one under which the only assets from which benefits are paid are the general assets of a union or of an employer, the administrator, officers, and employees of such plan shall be exempt from the bonding requirements of this section, and

(2) no bond shall be required of a fiduciary (or of any director, officer, or employee of such fiduciary) if such fiduciary—

(A) is a corporation organized and doing business under the laws of the United States or of any State;

(B) is authorized under such laws to exercise trust powers or to conduct an insurance business;

(C) is subject to supervision or examination by Federal or State authority; and

(D) has at all times a combined capital and surplus in excess of such a minimum amount as may be established by regulations issued by the Administration, which amount shall be at least $1,000,000.

Paragraph (2) shall apply to a bank or other financial institution which is authorized to exercise trust powers and the deposits of which are not insured by the Federal Deposit Insurance Corporation, only if such bank or institution meets bonding or similar re-

quirements under State law which the Administration determines are at least equivalent to those imposed on banks by Federal law.

The amount of such bond shall be fixed at the beginning of each fiscal year of the plan. Such amount shall be not less than 10 per centum of the amount of funds handled. In no case shall such bond be less than $1,000 nor more than $500,000, except that the Administration, after due notice and opportunity for hearing to all interested parties, and after consideration of the record, may prescribe an amount in excess of $500,000, which in no event may exceed 10 percent of the funds handled. For purposes of fixing the amount of such bond, the amount of funds handled shall be determined by the funds handled by the person, group, or class to be covered by such bond and by their predecessor or predecessors, if any, during the preceding reporting year, or if the plan has no preceding reporting year, the amount of funds to be handled during the current reporting year by such person, group, or class, estimated as provided in regulations of the Administration. Such bond shall provide protection to the plan against loss by reason of acts of fraud or dishonesty on the part of the plan official, directly or through connivance with others. Any bond shall have as surety thereon a corporate surety company which is an

acceptable surety on Federal bonds under authority granted by the Secretary of the Treasury pursuant to sections 6 through 13 of title 6, United States Code. Any bond shall be in a form or of a type approved by the Administration, including individual bonds or schedule or blanket forms of bonds which cover a group or class.

(b) It shall be unlawful for any plan official to whom subsection (a) applies, to receive, handle, disburse, or otherwise exercise custody or control of any of the funds or other property of any plan, without being bonded as required by subsection (a) and it shall be unlawful for any plan official of such plan, or any other person having authority to direct the performance of such functions, to permit such functions, or any of them, to be performed by any plan official, with respect to whom the requirements of subsection (a) have not been met.

(c) It shall be unlawful for any person to procure any bond required by subsection (a) from any surety or other company or through any agent or broker in whose business operations such plan or any party in interest in such plan has any control or significant financial interest, direct or indirect. Notwithstanding the preceding sentence, no employer shall be precluded from procuring the bond required by subsection (a) from a surety, company, or other entity,

or through an agent or broker in which such employer may have control or significant financial interest, direct or indirect.

(d) The Administration shall prescribe such regulations as may be necessary to carry out the provisions of this section including exempting a plan from the requirements of this section where it finds that (1) other bonding arrangements would be adequate to protect the interests of the beneficiaries and participants, or (2) the employer or an affiliate of such employer (within the meaning of section 207(b)(7))—

(A) is obligated to provide protection to the plan against loss by reason of acts of fraud or dishonesty on the part of plan officials, and

(B) demonstrates reasonable assurance to the Administration of fulfilling such obligation.

When, in the opinion of the Administration, the administrator of a plan offers adequate evidence of the financial responsibility of the plan, or that other bonding arrangements would provide adequate protection for the beneficiaries and participants, it may modify or exempt such plan from some or all of the requirements of this section.

LIMITATION ON ACTIONS

SEC. 213. No action may be commenced under this Act with respect to a fiduciary's breach of any responsibility,

duty, or obligation under this part, or with respect to a violation of this part, after the earlier of—

(1) six years after (A) the date of the last action which constituted a part of the breach or violation, or (B) in the case of an omission, the latest date on which the fiduciary could have cured the breach or violation, or

(2) three years after the earliest date (A) on which the plaintiff had actual knowledge of the breach or violation, or (B) on which a report from which he could reasonably be expected to have obtained knowledge of such breach or violation was filed with the Administration under this Act;

except that in the case of fraud or concealment, such action may be commenced not later than six years after the date of discovery of such breach or violation.

LIMITATION ON FIDUCIARY DUTIES OF GOVERNMENT OFFICIALS

SEC. 214. Notwithstanding any other provision of this Act, no Government official shall be a fiduciary or co-fiduciary with respect to actions taken in his official capacity regarding the establishment of plan provisions relating to benefits (including, but not limited to eligibility, benefit levels, and the form and method of payment of benefits), or the establishment of funding levels for benefits or administrative costs

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or the providing of funds to pay such benefits or meet such costs.

PART 3—ADMINISTRATION AND ENFORCEMENT

CRIMINAL PENALTIES

SEC. 301. (a) Any person who willfully violates any provision of part 1 or section 212 of this Act, or any regulation or order issued under any such provision, shall upon conviction be fined not more than $5,000 or imprisoned not more than one year, or both; except that in the case of such violation by a person not an individual, the fine imposed upon such person shall be a fine not exceeding $100,000.

(b) (1) Section 664 of title 18, United States Code, is amended by striking out the period at the end thereof and inserting in lieu thereof ", and any employee pension benefit plan subject to any provision of the Public Employee Retirement Income Security Act of 1978.".

(2) (A) Section 1027 of such title 18 is amended—

(i) by inserting "or by the Public Employee Retirement Income Security Act of 1978" after "(as amended from time to time)"; and

(ii) by inserting "or Act" after "such title" each place it appears.

(B) The heading for such section 1027 is amended to read as follows:

"§ 1027. **False statements and concealment of facts in relation to documents required by the Employee Retirement Income Security Act of 1974 or by the Public Employee Retirement Income Security Act of 1978".**

(C) The item relating to section 1027 in the table of sections for chapter 47 of such title 18 is amended to read as follows:

"1027. False statements and concealment of facts in relation to documents required by the Employee Retirement Income Security Act of 1974 or by the Public Employee Retirement Income Security Act of 1978.".

(3) Section 1954 of such title 18 is amended—

(A) by inserting "or to any provision of the Public Employee Retirement Income Security Act of 1978" after "Employee Retirement Income Security Act of 1974"; and

(B) by striking out all that follows "(b)" and inserting in lieu thereof " 'employee organization' and 'administrator' mean an employee organization and an administrator as defined in sections 3(4) and 3(16), respectively, of the Employee Retirement Income Security Act of 1974, or in sections 3(2) and 3(12), respectively of the Public Employee Retirement Income Security Act of 1978.".

CIVIL ENFORCEMENT

SEC. 302. (a) A civil action may be brought—

(1) by a participant or beneficiary—

(A) for the relief provided for in subsection (b) of this section, or

(B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan;

(2) by the Administration, or by a participant, beneficiary or fiduciary for appropriate relief under section 209;

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this Act or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this Act or the terms of the plan;

(4) by the Administration (A) to enjoin any act or practice which violates any provision of this Act, (B) to obtain other appropriate equitable relief (i) to redress such violation or (ii) to enforce any provision of this Act, or (C) to collect any civil penalty under subsection (j).

(b) Any administrator who fails or refuses to comply

with a request for any information which such administrator is required by this Act to furnish to a participant or beneficiary (unless such failure or refusal results from matters reasonably beyond the control of the administrator) by mailing the material requested to the last known address of the requesting participant or beneficiary within 30 days after such request may in the court's discretion be personally liable, in accordance with section 209, to such participant or beneficiary in the amount of up to $100 a day from the date of such failure or refusal, and the court may in its discretion order such other relief as it deems proper.

(c) (1) A plan may sue or be sued under this Act as an entity. Service of summons, subpoena, or other legal process of a court upon a trustee or an administrator of a plan in his capacity as such shall constitute service upon the plan. In a case where a plan has not designated in the summary plan description of the plan an individual as agent for the service of legal process, service upon the Administration shall constitute such service. The Administration, not later than 15 days after receipt of service under the preceding sentence, shall notify the administrator or any trustee of the plan of receipt of such service.

(2) Any money judgment under this Act against a plan shall be enforceable only against the plan as an entity and shall not be enforceable against any other person unless

liability against such person is established in his individual capacity under this Act.

(d) (1) Except for actions under subsection (a) (1) (B) of this section, the district courts of the United States shall have exclusive jurisdiction of civil actions under this Act brought by the Administration or by a participant, beneficiary, or fiduciary. State courts of competent jurisdiction and district courts of the United States shall have concurrent jurisdiction of actions under subsection (a) (1) (B) of this section.

(2) Notwithstanding section 94 of the National Banking Act (12 U.S.C. 94), where an action under this Act is brought in a district court of the United States, it may be brought in any district in the State where the plan is administered, where the breach took place, or where a defendant resides or may be found, and process may be served in any other district where a defendant resides or may be found.

(e) The district courts of the United States shall have jurisdiction without respect to the amount in controversy or the citizenship of the parties, to grant the relief provided for in subsection (a) of this section in any action.

(f) In any action under this Act by a participant, beneficiary, or fiduciary, the court in its discretion may allow a reasonable attorney's fee and costs of action to either party.

(g) A copy of the complaint in any action under this Act by a participant, beneficiary, or fiduciary (other than an action brought by one or more participants or beneficiaries under subsection (a) (1) (B) which is solely for the purpose of recovering benefits due such participants under the terms of the plan) shall be served upon the Administration by certified mail. The Administration shall have the right in its discretion to intervene in any such action.

(h) Suits by an administrator, fiduciary, participant, or beneficiary of a plan to review a final order of the Administration, to restrain the Administration from taking any action contrary to the provisions of this Act, or to compel the Administration to take action required under this Act, may be brought in any district court of the United States in the State where the plan has its principal office, or in the United States District Court for the District of Columbia.

(i) In all civil actions under this Act, attorneys appointed by the Administration may represent the Administration (except as provided in section 518(a) of title 28, United States Code).

(j) In the case of a transaction prohibited by section 206 by a party in interest with respect to a plan, the Administration may assess a civil penalty against such party in interest. The amount of such penalty may not exceed 5 percent of the amount involved, except that if the

transaction is not corrected (in such manner and within such correction period as the Administration shall prescribe by regulation), such penalty may be in an amount not more than 100 percent of the amount involved. For purposes of this subsection—

(1) the term "amount involved" means, with respect to a prohibited transaction, the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received; except that, in the case of services described in section 206(a)(3), the amount involved shall be only the excess compensation.

(2) in the case of the initial 5 percent penalty, the fair market value shall be determined as of the date on which the prohibited transaction occurs;

(3) in the case of the 100 percent penalty, the fair market value shall be the highest fair market value during the correction period; and

(4) the term "correct" means, with respect to a prohibited transaction, undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than that in which it would be if the party in interest were acting in accordance with the fiduciary standards described in part 2 of this subtitle.

CLAIMS PROCEDURE

SEC. 303. In accordance with regulations of the Administration, every plan shall—

(1) provide adequate notice in writing to any participant or beneficiary whose claim for benefits under the plan has been denied, setting forth the specific reasons for such denial, written in a manner calculated to be understood by the participant, and

(2) afford a reasonable opportunity to any participant whose claim for benefits has been denied for a full and fair review by the appropriate named fiduciary of the decision denying the claim.

INVESTIGATIVE AUTHORITY

SEC. 304. (a) The Administration shall have the power, in order to determine whether any person has violated or is about to violate any provision of this Act or any regulation or order thereunder—

(1) to make an investigation, and in connection therewith to require the submission of reports, books, and records, and the filing of data in support of any information required to be filed with the Administration under this Act, and

(2) to enter such places, inspect such books and records and question such persons as it may deem necessary to enable it to determine the facts relative to

such investigation, if it has reasonable cause to believe there may exist a violation of this Act, or any rule or regulation issued thereunder or if the entry is pursuant to an agreement with the plan.

The Administration may make available to any person actually affected by any matter which is the subject of an investigation under this section, and to any department or agency of the United States, information concerning any matter which may be the subject of such investigation.

(b) The Administration may not under the authority of this section require any plan to submit to the Administration any books or records of the plan more than once in any 12-month period, unless the Administration has reasonable cause to believe there may exist a violation of this Act or any regulation or order thereunder.

(c) For the purposes of any investigation provided for in this Act, the provisions of sections 9 and 10 (relating to the attendance of witnesses and the production of books, records, and documents) of the Federal Trade Commission Act (15 U.S.C. 49, 50) are hereby made applicable (without regard to any limitation in such sections respecting persons, partnerships, banks, or common carriers) to the jurisdiction, powers, and duties of the Administration or any officers designated by it. To the extent it considers appropriate, the Administration may delegate its investigative

functions under this section with respect to insured banks acting as fiduciaries of plans to the appropriate Federal banking agency (as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))).

REGULATIONS

SEC. 305. The Administration may prescribe such regulations as it finds necessary or appropriate to carry out the provisions of this Act. Among other things, such regulations may define accounting, technical and trade terms used in such provisions; may prescribe forms (subject to section 110); and may provide for the keeping of books and records, and for the inspection of such books and records (subject to section 304 (a) and (b)).

COOPERATION WITH STATES

SEC. 306. In order to avoid unnecessary expense among Federal, State, and local government agencies, the Administration shall cooperate with State and local governments in the exchange of information and data on plans and shall make such arrangements as may be necessary to provide State and local governments with information and data requested by them at the lowest possible cost.

ADMINISTRATION

SEC. 307. (a) Subchapter II of chapter 5, and chapter 7, of title 5, United States Code (relating to administrative procedure), shall be applicable to this Act.

(b) No employee of the Administration shall administer or enforce this Act with respect to any employee benefit plan under which he is a participant or beneficiary, any employee organization of which he is a member, or any employer organization in which he has an interest.

AUTHORIZATIONS

SEC. 308. There are hereby authorized to be appropriated such sums as may be necessary to enable the Administration to carry out its functions and duties under this Act.

SEPARABILITY PROVISIONS

SEC. 309. If any provision of this Act, or the application of such provision to any person or circumstances, shall be held invalid, the remainder of this Act, or the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

INTERFERENCE WITH RIGHTS PROTECTED UNDER ACT

SEC. 310. It shall be unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the provisions of a plan, this Act, or for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan or this Act. It shall be unlawful for any person to discharge, fine, suspend, expel, or discriminate against any person

because he has given information or has testified or is about to testify in any inquiry or proceeding relating to this Act. The provisions of section 302 shall be applicable in the enforcement of this section.

COERCIVE INTERFERENCE

SEC. 311. It shall be unlawful for any person through the use of fraud, force, violence, or threat of the use of force or violence, to restrain, coerce, intimidate, or attempt to restrain, coerce, or intimidate any participant or beneficiary for the purpose of interfering with or preventing the exercise of any right to which he is or may become entitled under the plan or this Act. Any person who willfully violates this section shall be fined $10,000 or imprisoned for not more than one year, or both.

TRANSMITTAL OF INFORMATION; DUTIES OF SECRETARY OF HEALTH, EDUCATION, AND WELFARE

SEC. 312. (a) The Administration shall transmit to the Secretary of Health, Education, and Welfare copies of the information contained in the annual report pursuant to section 103(g), and such other information insofar as it relates to the information described in section 103(g).

(b) The Administration, after consultation with the Secretary of Health, Education, and Welfare, may prescribe such regulations as may be necessary to carry out the provisions of subsection (a).

(c) Section 1131(a) of the Social Security Act is amended to read as follows:

"NOTIFICATION OF SOCIAL SECURITY CLAIMANT WITH RESPECT TO DEFERRED VESTED BENEFITS

"SEC. 1131. (a) Whenever—

"(1) the Secretary makes a finding of fact and a decision as to—

"(A) the entitlement of any individual to monthly benefits under section 202, 223, or 228,

"(B) the entitlement of any individual to a lump-sum death payment payable under section 202(i) on account of the death of any person to whom such individual is related by blood, marriage, or adoption, or

"(C) the entitlement under section 226 of any individual to hospital insurance benefits under part A of title XVIII, or

"(2) the Secretary is requested to do so—

"(A) by any individual with respect to whom the Secretary holds information obtained under section 6057 of the Internal Revenue Code of 1954, or with respect to whom the Employee Benefit Administration holds information obtained under section 312(a) of the Public Employee Retirement Income Security Act of 1978, or

"(B) in the case of the death of the individual referred to in subparagraph (A), by the individual who would be entitled to payment under section 204(d) of this Act,

he shall transmit to the individual referred to in paragraph (1) or the individual making the request under paragraph (2) any information, as reported by the plan administrator or the employer, regarding any deferred vested benefit transmitted to the Secretary pursuant to such section 6057 or to such Administration pursuant to such section 312(a) with respect to the individual referred to in paragraph (1) or (2)(A) or the person on whose wages and self-employment income entitlement (or claim of entitlement) is based.".

ADVISORY COUNCIL ON GOVERNMENTAL PLANS

SEC. 313. (a)(1) There is hereby established an Advisory Council on Governmental Plans (hereinafter in this section referred to as the "Council") consisting of eleven members appointed by the President. Not more than six members of the Council shall be members of the same political party. The President shall annually designate one member to serve as chairman.

(2) Members shall be persons qualified to appraise the programs instituted under this Act.

(3) As determined by the President, the members of

the Council shall be representative of the employees, the employers, and the general public having a direct interest in the State government plans and the local government plans covered under this Act.

(4) Members shall serve for terms of three years except that of those first appointed, four shall be appointed for terms of one year, four shall be appointed for terms of two years, and three shall be appointed for terms of three years. A member may be reappointed. A member appointed to fill a vacancy shall be appointed only for the remainder of such term. A majority of members shall constitute a quorum and action shall be taken only by a majority vote of those present and voting. The Council shall meet at least twice each year and at such other times as may be determined by the chairman or as may be requested by the Administration.

(b) It shall be the duty of the Council to advise the Administration with respect to the carrying out of its functions under this Act and to submit to the Administration recommendations with respect thereto. The Administration shall actively consider any such recommendations of the Council prior to issuing regulations or otherwise carrying out its functions under this Act. The Administration shall include each recommendation which it has received from the Council during the preceding calendar year in the annual report to the Congress submitted pursuant to section 314.

(c) The Council may establish voluntary guidelines for plans with respect to matters, including but not limited to, funding and vesting, for which requirements are not established by this Act. In establishing any such guidelines, the Council shall seek the advice of individuals and groups interested in policies applicable to plans, and may hold such hearings as it deems necessary in seeking such advice.

(d) The Administration shall furnish to the Council an executive secretary and such professional, secretarial, clerical, and other services as the Administration deems necessary for the Council to conduct its business. The Administration shall call upon other agencies of the Government for statistical data, reports, and other information which the Council requests in the performance of its duties. The head of any such agency shall provide any data, report, or other information which is so requested.

(e) Members of the Council shall, for each day (including traveltime) during which they are attending meetings or conferences of the Council or otherwise engaged in the business of the Council, be compensated at a rate fixed by the Administration which is not in excess of the daily equivalent of the annual rate of basic pay in effect for grade GS–18 of the General Schedule, and while away from their homes or regular places of business they may be allowed

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travel expenses, including per diem in lieu of subsistence, as authorized by section 5703 of title 5, United States Code.

(f) The Federal Advisory Committee Act shall not apply to the Council established by this section.

RESEARCH, STUDIES, AND ANNUAL REPORT

SEC. 314. (a) (1) The Administration is authorized to undertake research and surveys and in connection therewith to collect, compile, analyze and publish data, information, and statistics relating to plans, and to pension and welfare plans not subject to this Act.

(2) The Administration is authorized and directed to undertake research studies relating to plans, including but not limited to (A) the effects of this Act upon the provisions and costs of plans, (B) the role of pension plans in meeting the economic security needs of the Nation, and (C) the operation of pension plans including types and levels of benefits, degree of reciprocity or portability, and financial and actuarial characteristics and practices, and methods of encouraging the growth of the pension system.

(3) The Administration may, as it deems appropriate or necessary, undertake other studies relating to plans, the matters regulated by this Act, and the enforcement procedures provided for under this Act.

(4) The research, surveys, studies, and publications

referred to in this subsection may be conducted directly, or indirectly through grant or contract arrangements.

(b) The Administration shall submit annually a report to the Congress covering its administration of this Act for the preceding year, and including (1) an explanation of any actions taken under section 109; (2) the status of cases in enforcement status; (3) recommendations received from the Advisory Council on Governmental Plans during the preceding year; and (4) such information, data, research findings, studies, and recommendations for further legislation in connection with the matters covered by this Act as it may find advisable.

(c) The Administration shall publish not less than annually a report which shall include, but shall not be limited to, the following:

(1) the number of plans (including an explanation of any increase or decrease in the number of plans since the publication of the previous report) ;

(2) the number of active and non-active participants of such plans;

(3) the amount of plan assets, income (including, but not limited to, employee and employer contributions and investment income), and expenses (including, but not limited to, benefit payments) ;

(4) the amount of plan assets by investment category; and

(5) an analysis of the actuarial position of defined benefit plans.

The information required by this subsection shall be shown by type and size of plan.

EFFECT ON OTHER LAWS

SEC. 315. (a) Except as provided in subsection (c), the provisions of sections 203, 204, 205, 206, 207, 208, 209, and 210 of this Act shall supersede all laws of any State or any political subdivision of a State insofar as such laws may now or hereafter relate to the subject matter of such sections.

(b) Except as provided in subsection (c), the provisions of this Act other than the provisions referred to in subsection (a) shall supersede all laws of any State or any political subdivision of a State only insofar as such laws (1) may now or hereafter relate to any employee pension benefit plan described in section 4(a) and not exempt under section 4(b), and (2) prevent the application of such provisions.

(c) (1) Except as provided in paragraph (2), nothing in this Act shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

(2) Neither a plan described in section 4(a), which is not exempt under section 4(b), nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

(d) (1) Any plan and any trust forming a part of a plan which meet the requirements of this Act, as determined by the Administration, shall be deemed to be a qualified plan and a qualified trust, respectively, which meet the requirements of section 401 and of subpart B of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954. Any determination to disqualify a plan or trust for purposes of the Internal Revenue Code of 1954 shall be made only if, after the application of all other remedies authorized with respect to such requirement by this Act, the plan or trust fails to comply with a requirement of this Act.

(2) A plan and a trust forming a part of a plan shall be deemed to be organizations described in sectoin 401(a) of such Code and exempt from taxation under section 501(a) of such Code whether or not such plan and trust meet the

requirements of this Act and without regard to section 503(a)(1)(B) of such Code.

(3) Section 6058 of the Internal Revenue Code of 1954 shall not apply to any plan or to any employer covered by a plan.

(e) This section shall take effect at the beginning of the second calendar year following the establishment of the Administration, but shall not apply with respect to any cause of action which arose, or any act or omission which occurred, before the beginning of the second calendar year following the establishment of the Administration.

EFFECTIVE DATES

SEC. 316. (a) Except as provided in subsections (b) and (c) and in sections 101(a) and 315(e), this Act shall take effect at the beginning of the second calendar year following the establishment of the Administration pursuant to section 3001(a) of the Employee Retirement Income Security Act of 1974.

(b) The provisions of this Act authorizing the Administration to promulgate regulations and the provisions of section 313 shall take effect on the date of the establishment of the Administration pursuant to section 3001(a) of the Employee Retirement Income Security Act of 1974.

(c) The provisions of sections 307, 308, and 309 shall take effect on the date of the enactment of this Act.

TITLE II—EMPLOYEE BENEFIT ADMINISTRATION

ESTABLISHMENT

SEC. 1001. (a) Subtitle A of title III of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"Subtitle A—Employee Benefit Administration

"ESTABLISHMENT

"SEC. 3001. (a) Not later than one year after the date of the enactment of the Employee Benefit Administration Act of 1978, the President shall, by order, establish an Employee Benefit Administration (hereinafter in this subtitle referred to as the 'Administration'). Such Administration shall be independent and may, in the discretion of the President, be within any department or agency of the United States.

"(b) (1) (A) There shall be at the head of the Administration a Board of Directors (hereinafter in this subtitle referred to as the 'Board') which shall consist of—

"(i) the special liaison officer for the Secretary of Labor appointed under paragraph (2),

"(ii) the special liaison officer for the Secretary of the Treasury appointed under paragraph (3), and

"(iii) three additional members appointed by the President, by and with the advice and consent of the

Senate, selected from a list of nominees submitted jointly by the Secretary of Labor and the Secretary of the Treasury.

The President shall designate one of the members of the Board to serve as Chairman. All functions and powers of the Administration shall be vested in, and exercised by, the Board.

"(B) Members of the Board shall serve for terms of 6 years, except the special liaison officer for the Secretary of the Treasury initially appointed under clause (ii) of subparagraph (A) shall serve for a term of 3 years, and of the 3 members of the Board initially appointed under clause (iii) of subparagraph (A), one shall serve for a term of 2 years, one shall serve for a term of 4 years, and one shall serve for a term of 6 years.

"(C) A member of the Board may serve as a member of the Board after the expiration of his term until a successor has taken office as a member of the Board.

"(D) An individual appointed to fill a vacancy occurring other than by the expiration of a term of office shall be appointed only for the unexpired term of the member such individual succeeds.

"(E) Not more than 3 members of the Board may be affiliated with the same political party.

"(F) Members of the Board shall receive compensation equivalent to the compensation paid at level III of the Executive Schedule.

"(G) All members of the Board shall be reimbursed for travel, subsistence, and other necessary expenses incurred in the performance of their duties as members of the Board.

"(2) There is established within the office of the Secretary of Labor, the position of special liaison officer to the Administration. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of Labor. The special liaison officer shall report regularly to the Secretary of Labor on the activities of the Administration.

"(3) There is established within the office of the Secretary of the Treasury the position of special liaison officer to the Administration. The special liaison officer shall be appointed by the President, by and with the advice and consent of the Senate, from a list of nominees submitted to the President by the Secretary of the Treasury. The special liaison officer shall report regularly to the Secretary of the Treasury on the activities of the Administration.

"(4) There shall be in the Administration an Executive Director appointed by the Board who shall be the chief ad-

ministrative officer of the Administration and who shall have such functions and authority as may be delegated to him by the Board.

"(5) There shall be in the Administration not more than four officers (including the Executive Director, officers transferred under section 3003(c), and officers of the Pension Benefit Guaranty Corporation) appointed by the Board without regard to the provisions of title 5 of the United States Code governing appointments in the competitive service. Such officers shall receive compensation at level IV or level V of the Executive Schedule, as determined by the President.

"(c) The Pension Benefit Guaranty Corporation established within the Department of Labor under section 4002 is, effective upon the establishment of the Administration, established within the Administration.

"ADMINISTRATIVE PROVISIONS

"SEC. 3002. (a) The Board is authorized to prescribe such policies, standards, criteria, procedures, rules, and regulations as it may deem to be necessary or appropriate to perform functions now or hereafter vested in it.

"(b) Except as otherwise expressly provided by law, the Board may delegate any of its functions to such officers and employees of the Administration (and to officers or em-

ployees the services of whom are utilized under section 3004 (f)) as it may designate, and may authorize such successive redelegations of such function as it may deem to be necessary or appropriate. The Board may organize the Administration as it may deem to be necessary or appropriate.

"(c) The Board shall cause a seal of office to be made for the Administration of such design as it shall approve, and judicial notice shall be taken of such seal.

"(d) The Board may accept unconditional gifts or donations of money or property, real, personal, or mixed, tangible or intangible.

"(e) The Board may enter into and perform contracts, leases, cooperative agreements, or other similar transactions with any public agency or instrumentality or with any person, firm, association, corporation, or institution.

"(f) The Board may perform such other activities as may be necessary for the effective fulfillment of its administrative duties and functions.

"(g) The Board may appoint, employ, and fix the compensation of such officers and employees, including attorneys and actuaries, as are necessary to perform the functions vested in it, and prescribe their authority and duties.

"TRANSFERS AND CONSOLIDATION

"SEC. 3003. (a) Following establishment of the Board under section 3001, the President shall, by order, transfer to and vest in the Board—

"(1) the function and duties of the Secretary of Labor under titles I and II of this Act, and under the Welfare and Pension Plans Disclosure Act to the extent that such Act continues to apply as provided in section 111 (a) (1) of this Act,

"(2) such functions and duties of the Secretary of the Treasury under titles I and II of this Act and under the Internal Revenue Code of 1954, relating to employee benefit plans and governmental plans, as the President shall, in such order, designate, and

"(3) such other functions and duties of any department or agency of the United States, relating to employee benefit plans and governmental plans, as the President may, in such order, designate.

An order under this subsection shall be promulgated, and shall take effect, not later than one year after the date of enactment of the Employee Benefit Administration Act of 1978 unless the President determines, and provides in such order, a later effective date with respect to any function or duty the later transfer of which may be reasonably necessary. Such order shall provide for the transfer of all functions and

duties relating to the qualification and disqualification of employee benefit plans and governmental plans subject to the Internal Revenue Code of 1954 and shall provide for the transfer of such other functions and duties under various provisions of the Internal Revenue Code of 1954 (including, but not limited to, other functions under sections 219, 220, 401, 403 through 415, 4971, 4975, 6057, 6058, 6059, 6690, 6692, 6693, and 7476) as may be necessary to effectuate the maximum feasible consolidation in the Administration of all administrative and related functions (including enforcement functions) of the Federal Government respecting employee benefit plans and governmental plans and to otherwise carry out the purposes of the Employee Benefit Administration Act of 1978. Such order may provide that certain functions and duties of the Secretary of the Treasury (including, but not limited to, certain functions and duties under sections 219, 220, 402, 403, 408, 409, and 6693) which concern employee benefit plans and governmental plans, individual retirement accounts, and other similar or related matters, but which are not necessary to effectuate such maximum feasible consolidation and otherwise carry out such purposes and which are necessary to the effective administration of the Internal Revenue Code of 1954 shall not be transferred under this subsection.

"(b) In the case of any function or duty transferred under an order under subsection (a), all references in any provision of law to the Secretary of Labor, to the Secretary of the Treasury, or the head of any agency referred to in subsection (a) (3) (or to any other person having the authority, prior to such transfer, to carry out such function or duty) shall be deemed to be a reference to the Board and all references to the Department of Labor, the Department of the Treasury, or to a department or agency described in subsection (a) (3) with respect to any such function or duty shall be deemed a reference to the Administration.

"(c) There shall be transferred by the President to the Administration such officers and components of the Department of Labor and the Department of the Treasury (including officers and components of the Internal Revenue Service) as may be necessary to maintain and improve administration of the functions transferred under an order under subsection (a). The President may also transfer such officers and components of other departments and agencies as may be appropriate.

"(d) (1) The Board shall promulgate regulations providing for the maximum consolidation of all reports respecting employee benefit plans (including reports required under title IV), and governmental plans required to be provided pursuant to the provisions of this Act, provisions of the

Internal Revenue Code of 1954, or under any other provision of law. If the application of any such provision requiring reporting would not carry out the purposes of this subsection, such provision shall be applied in a manner consistent with such purposes.

"COORDINATION BETWEEN AGENCIES

"SEC. 3004. (a) In carrying out its functions under this Act and the Public Employee Retirement Income Security Act of 1978, the Board shall notify the Secretary of the Treasury of any matter respecting employee benefit plans and governmental plans, which may affect the administration by the Secretary of provisions of the Internal Revenue Code of 1954 relating to such plans and to persons affected by such plans. In carrying out his functions under the Internal Revenue Code of 1954, the Secretary of the Treasury shall notify the Board of any matter respecting employee benefit plans and governmental plans which may affect the administration by the Board of the provisions of this Act and the Public Employee Retirement Income Security Act of 1978 and the provisions of the Internal Revenue Code of 1954 relating to such plans and to persons affected by such plans.

"(b) The Secretary of the Treasury shall make available to the Board, upon request, any information, documents, returns, or other items in its possession relating to employee

benefit plans and governmental plans, which the Board deems necessary to carry out its functions and duties under this Act and the Public Employee Retirement Income Security Act of 1978 and under the Internal Revenue Code of 1954. The Board shall make available, upon request, to the Secretary of the Treasury any information, documents, reports, or other items relating to employee benefit plans and governmental plans which the Secretary deems necessary to carry out his functions and duties under the Internal Revenue Code of 1954. Any such information, documents, returns, or other items made available under this subsection to the Board or to the Secretary shall be subject to the same rules respecting confidentiality as such information, documents, returns, or other items would have been subject if not so made available.

"(c) Whenever in this Act, the Public Employee Retirement Income Security Act of 1978, or in any provision of law amended by this Act or the Public Employee Retirement Income Security Act of 1978, the Secretary of the Treasury and the Board are required to carry out provisions relating to the same subject matter (as determined by them) they shall consult with each other and shall develop rules, regulations, practices, and forms which, to the extent appropriate for the efficient administration of such provisions, are designed to reduce duplication of effort, duplication of reporting, conflicting or overlapping requirements, and the

burden of compliance with such provisions by plan administrators, employers, and participants and beneficiaries.

"(d) The penalties imposed under sections 6690 and 6692 and the taxes imposed under sections 4971 and 4975 of the Internal Revenue Code of 1954 may be delayed, reduced, or waived in the discretion of the Board.

"(e) Upon the request of the Secretary of the Treasury, the Board shall make a determination respecting the qualification of any employee benefit plan and any governmental plan, or shall make any other determination under this Act or the Public Employee Retirement Income Security Act of 1978 which may be necessary to assist the Secretary in carrying out his functions under the Internal Revenue Code of 1954. The Board shall make such determination and notify the Secretary thereof as promptly as practicable.

"(f) In order to avoid unnecessary expense and duplication of functions among Government agencies, the Board may make such arrangements or agreements for cooperation or mutual assistance in the performance of its functions under this Act and the Public Employee Retirement Income Security Act of 1978, and the functions of any such agency as it finds to be practicable and consistent with law. The Board may utilize, on a reimbursable or other basis, the facilities or services, of any department, agency, or establishment of the United States or of any State or political subdivision of a

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State, including the services, of any of its officers and employees, with the lawful consent of such department, agency, or establishment; and each department, agency, or establishment of the United States is authorized and directed to cooperate with the Board and, to the extent permitted by law, to provide such information and facilities as it may request for assistance in the performance of its functions under this Act and the Public Employee Retirement Income Security Act of 1978. The Attorney General or his representative shall receive from the Secretary of the Treasury and the Board for appropriate action such evidence developed in the performance of their functions under this Act and the Public Employee Retirement Income Security Act of 1978 as may be found to warrant consideration for criminal prosecution under the provisions of this Act, the Public Employee Retirement Income Security Act of 1978, or other Federal law.

"(g) Prior to promulgating any regulations, respecting any activity which is the subject of any regulation under this Act or the Public Employee Retirement Income Security Act of 1978, other Federal departments, agencies, and establishments shall consult with the Administration with a view to avoiding unnecessary conflict, duplication, or inconsistency between the regulations of such agency and the regulations and other actions of the Administration.

"CERTAIN PROCEDURES

"SEC. 3005. (a) The Board shall require a person applying for a determination of whether an employee benefit plan or a governmental plan, or a trust which is a part of such plan meets the requirements of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954 to provide evidence satisfactory to the Board that the applicant has notified each employee who qualifies as an interested party (within the meaning of regulations prescribed under section 7476 (b) (1) of such Code) of the application for a determination.

"(b) Whenever an application is made to the Board for a determination of whether a plan or a trust which is a part of such a plan or meets the requirements of part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954, the Board shall upon request afford an opportunity to comment on the application at any time within 45 days after receipt thereof to—

"(1) any employee or class of employee qualifying as an interested party within the meaning of the regulations referred to in subsection (a), and

"(2) the Pension Benefit Guaranty Corporation.

"(c) (1) The Pension Benefit Guaranty Corporation and, upon petition of a group of employees referred to in paragraph (2), the Secretary of Labor, may intervene in any

action brought for declaratory judgment under section 7476 of the Internal Revenue Code of 1954 in accordance with the provisions of such section. The Pension Benefit Guaranty Corporation is permitted to bring an action under such section 7476 under such rules as may be prescribed by the United States Tax Court.

"(2) The Secretary of Labor may not intervene under paragraph (1) unless he has been requested in writing to do so by the lesser of—

"(A) 10 employees, or

"(B) 10 percent of the employees,

who qualify as interested parties within the meaning of the regulations referred to in subsection (a).

"TRANSITIONAL AND SAVINGS PROVISIONS

"SEC. 3006. (a) All orders, determinations, rules, regulations, directives, authorizations, designations, permits, contracts, certificates, licenses, privileges, and other actions—

"(1) which have been issued, made, granted, or allowed to become effective by the Secretary of Labor or the Secretary of the Treasury or agency or official thereof (or by any other agency or official the functions and duties of which are transferred pursuant to section 3003(a)(3)), or by a court of competent jurisdiction, in the performance of functions which are transferred under this title, and

"(2) which are in effect at the time the Employee Benefit Administration Act of 1978 takes effect,

shall continue in effect according to their terms until modified, terminated, superseded, set aside, or revoked by the Board, other authorized officials, a court of competent jurisdiction, or by operation of law.

"(b) Except as provided in subsection (e)—

"(1) the provisions of this title shall not affect any proceeding pending, at the time the Employee Benefit Administration Act of 1978 takes effect, before any department or agency (or component thereof) regarding functions which are transferred by this title; and

"(2) such proceedings shall be continued, orders shall be issued in such proceedings, appeals shall be taken therefrom, and payments shall be made pursuant to such orders as if the Employee Benefit Administration Act of 1978 had not been enacted.

Orders issued in any such proceedings shall continue in effect until modified, terminated, superseded, or revoked by a duly authorized official, by a court of competent jurisdiction, or by operation of law. Nothing in this subsection shall be deemed to prohibit the discontinuance or modification of any such proceeding under the same terms and conditions, and to the same extent, that such proceeding could

have been discontinued if the Employee Benefit Administration Act of 1978 had not been enacted.

"(c) Except as provided in subsection (e)—

"(1) the provisions of this title shall not affect suits commenced prior to the date the Employee Benefit Administration Act of 1978 takes effect, and

"(2) in all such suits proceedings shall be had, appeals taken, and judgments rendered, in the same manner and effect as if the Employee Benefit Administration Act of 1978 had not been enacted.

"(d) No investigation, suit, action, or other proceeding commenced by or against any officer in his official capacity as an officer of any department or agency, functions of which are transferred by this title, shall abate by reason of the enactment of the Employee Benefit Administration Act of 1978. No cause of action by or against any department or agency, functions of which are transferred by this title, or by or against any officer thereof in his official capacity shall abate by reason of the enactment of the Employee Benefit Administration Act of 1978. Causes of actions, suits, actions, or other proceedings may be asserted by or against the United States or such official as may be appropriate and, in any litigation pending when the Employee Benefit Administration Act of 1978 takes effect, the court may at any time, on

its own motion or that of any party, enter any order which will give effect to the provisions of this section.

"(e) If, before the date on which the Employee Benefit Administration Act of 1978 takes effect, any department or agency, or officer thereof in his official capacity, is a party to a proceeding referred to in subsection (b) or a suit referred to in subsection (c) and under this title any function of such department, agency, or officer is transferred to the Board, or any other official, then such proceeding or suit shall be continued as if the Employee Benefit Administration Act of 1978 had not been enacted with the Board, or other official as the case may be, substituted.

"(f) The provisions of this Act amended or repealed by the Employee Benefit Administration Act of 1978 shall continue in force and effect until such time as functions and duties are transferred to the Administration under section 3003. In the case of any functions and duties not transferred, such provisions shall be deemed to continue to apply to the extent such continued application will not interfere with the application of this title, as amended.

"INCIDENTAL TRANSFERS

"SEC. 3007. The Director of the Office of Management and Budget is authorized and directed to make such additional incidental dispositions of personnel, personnel positions, assets, liabilities, contracts, property, records, and

unexpended balances of appropriations, authorizations, allocations, and other funds held used, arising from, available to, or to be made available in connection with functions which are transferred by or which revert under this title, as the Director deems necessary and appropriate to accomplish the intent and purpose of this title.

"DEFINITIONS

"SEC. 3008. For purposes of this title:

"(1) The term 'employee benefit plan' has the same meaning such term has in section 3(3) of this Act (without regard to section 4).

"(2) The term 'governmental plan' has the same meaning such term has in section 3(32) of this Act when used with respect to functions and duties under this Act, and has the same meaning such term has in section 414(d) of the Internal Revenue Code of 1954 when used with respect to functions and duties under such Code.".

(b) The table of contents for subtitle A of title III of such Act is amended to read as follows:

"Subtitle A—Employee Benefit Administration

"Sec. 3001. Establishment.
"Sec. 3002. Administrative provisions.
"Sec. 3003. Transfers and consolidation.
"Sec. 3004. Coordination between agencies.
"Sec. 3005. Certain procedures.
"Sec. 3006. Transitional and savings provisions.
"Sec. 3007. Incidental transfers.
"Sec. 3008. Definitions.".

MISCELLANEOUS AND CONFORMING AMENDMENTS

SEC. 1002. (a) Section 512 (a) (1) of the Employee Retirement Income Security Act of 1974 is amended by striking out "Secretary" and inserting in lieu thereof "President". The amendment made by this subsection shall take effect with respect to members appointed to the Advisory Council on Employee Welfare and Pension Benefit Plans after the date of the enactment of this Act. Each member appointed to such Council before such date of enactment shall continue in office until the expiration of his term.

(b) (1) Sections 3041 and 3042 of such Act and section 7701 (a) (35) of the Internal Revenue Code are each amended by striking out "Joint" in each place it appears.

(2) Section 3041 of such Act is amended by striking out "Secretary of Labor and the Secretary of the Treasury" and substituting "Board of Directors of the Employee Benefit Administration".

(3) Section 4002 (a) of such Act is amended by striking out "Department of Labor" and substituting "Employee Benefit Administration".

(4) Section 4002 (d) of such Act is amended—

(A) by striking out the first sentence and inserting in lieu thereof the following: "The board of directors of the corporation shall consist of the individuals who are members of the Board of the Employee Benefit Admin-

istration, and the chairman of the board of directors shall be the individual who is the Chairman of the Board of such Administration."; and

(B) by striking out the third sentence.

(5) (A) Sections 101(d) and 104(d) of such Act are each amended by striking out "to the Secretaries of Labor and the Treasury, see section 3004" and substituting "under this and other provisions of law, see section 3003(d)".

(B) Section 4971(e) of the Internal Revenue Code of 1954 is amended by striking out the third sentence thereof and substituting:

"For provisions relating to waiver of the imposition of the tax imposed under this subsection, see section 3004 of title III of the Employee Retirement Income Security Act of 1974.".

(C) Section 6057(g) of such Code is amended by striking out "coordination between the Department of the Treasury and the Department of Labor with regard to" and inserting in lieu thereof "consolidation of the" and by striking out "3004" and substituting "3003".

(D) Section 6058(d) and section 6059(d) of such Code are each amended by striking out "coordination between the Department of the Treasury and the Department of Labor" and inserting in lieu thereof "consolidation of reporting requirements under this and other provisions of law" and by striking out "3004" and substituting "3003".

(E) Section 4975 (i) of such Code is amended to read as follows:

"(i) CROSS REFERENCE.—

"For provisions permitting waiver of imposition of the tax imposed by subsection (b), see section 3004 of the Employee Retirement Income Security Act of 1974.".

(F) Section 7476 (b) (3) of such Code is amended by striking out "Internal Revenue Service" and inserting in lieu thereof "Employee Benefit Administration".

Mr. SIMON. We have a series of witnesses. Before we call the witnesses, I would like to call on my colleague, John Erlenborn, for any statement he might wish to make.

Mr. ERLENBORN. Thank you, Mr. Chairman.

First of all let me welcome you back to DuPage County. I know you campaigned here in the past.

Mr. SIMON. With no great success in DuPage County, I might add.

Mr. ERLENBORN. You probably should watch what our colleague, the Secretary of State, has been doing here in Illinois because he carried DuPage County.

Mr. SIMON. That is what I understand.

Mr. ERLENBORN. It is good to have you here. I would like to welcome in addition the witnesses and visitors to DuPage County this morning for this important hearing into the issue of public pension plans.

Several years ago in this same building we held a similar hearing to gather reaction to a bill that was introduced by John Dent and me, providing for stringent Government regulation of public pension plans. We stated at that time that the bill was introduced for discussion only. It never was seriously considered for reporting from our committee and passage on the floor.

This hearing and others which will follow are concerned with a new bill, one which is not designed to bring all public pension plans under the thumb of the Federal Government but rather to provide protection for all of the parties involved.

For many years pension plans for public employees were considered one of those little hidden costs of government. The plans were not terribly important to elected officials or to the taxpaying public because, first, there were not that many public employees. Second, they weren't paid that much. Third, the benefits and plans were relatively low.

Over the recent past, however, we have seen an explosion in the number of public employees at the State and local levels, an explosion in their rates of pay and similar fireworks in the amount, type, and timing of benefits available under their pension plans.

Most public pension plans are "contributory," meaning the employee has some portion of his pay set aside for his pension. That amount is usually matched, to a greater or lesser degree, by the government that employs him. This is different from most private pension plans which typically include no direct employee contribution to the plan.

A study into the size, type, and numbers of public pension plans was approved by this subcommittee on March 15. That study showed that there are serious deficiencies in the reporting, disclosure, fiduciary standards, and plan administration practices among the nearly 7,000 State and local public pension plans.

The 68 Federal pension plans are not much better. But we are beginning to correct some of the problems. Particularly I am pleased with the signing by President Carter 10 days ago of H.R. 9701 (P.L. 95–595) cosponsored by Chairman Dent and myself, that would require an ERISA-type reporting by all of the Federal pension plans. That law deals specifically with reporting as to actuarial and accounting conditions of the Federal plans.

Congressman Dent of Pennsylvania, who has been the chairman of this subcommittee and who will be retiring at the end of this year, has been a driving force behind legislation to improve the administration and operation of pension plans in this country.

Earlier this year we introduced a bill to begin correcting some of the problems described in the public pension report. That bill, known as PERISA, is not designed to be nearly as all-encompassing as the law which sought to correct the problems in the private sector.

PERISA is designed to deal with the unique problems encountered in the public pension area.

PERISA seeks to help public employees, government officials, and taxpayers establish the true financial condition of a public pension plan. PERISA provides for improvements in actuarial, accounting, and auditing procedures.

It seeks to help insure that the assets of a public pension plan are managed for the benefit of the plan participants by clarifying rules regarding investments made by plan managers.

It seeks to help the public employee determine what his pension plan will be worth to him upon his retirement.

Finally, it seeks to help all of us to be certain that our tax dollars are being used in the best, most efficient way to fund these pension plans.

The enactment of PERISA will not in and of itself serve to solve all of the problems found in public pension plans. It does not directly, for instance, address the matter of funding these plans.

It is not the intent of this subcommittee to enact legislation which would serve to take control of the operation of public pension plans. It is our intent, however, to do what must be done to protect the rights of all parties involved in public pension matters: the governments, the employees, and the taxpayers.

Thank you very much.

Mr. SIMON. Thank you very much, Mr. Erlenborn.

As I see our witness list, I believe we have three of the witnesses here. And I see our first witness has just arrived here. Let me add that I note that on the witness list Mr. A. A. Weinberg is not one of the witnesses. We would not expect any formal statement. But at the end of our witness list if it is all right with Mr. Erlenborn—so you are going to be with Senator Egan? All right. We will get your wisdom anyway. My guess is that you know more than all the rest of us in the room together.

Professor Schotland, professor of law, Georgetown University Law Center, I don't know if you have had a chance to catch your breath yet. We will be happy to proceed immediately with you, Professor Schotland.

STATEMENT OF ROY A. SCHOTLAND, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY

Mr. SCHOTLAND. Thank you, Congressman Simon, Mr. Erlenborn.

I am sure there are others in the room who are more knowledgeable about the public pension sector than I. But I had the pleasure of being at your hearing 3 years ago on the earlier version of this bill. I have been involved one way or another in the pension sphere and in the specific aspect of conflict of interest in the financial sector generally.

I will go briefly through portions of my statement and submit it if I may for the record.

Mr. SIMON. Your statement will be entered in the record.

Mr. SCHOTLAND. I would also like to submit for the record and as an appendix to that statement a four-page item setting forth various questions about conflicts of interest in the investment management and administration of State and local pension funds.

These questions were prepared not by me, but used by me, at a recent meeting of the National Association of State Pension Investment Officers. They were prepared as a result of discussions with me about conflicts and are meant only as a list to focus discussion and to focus self-policing, if you will, for any state or local pension plan.

Mr. SIMON. We will also enter that in the record.

[The prepared testimony of Mr. Schotland follows:]

TESTIMONY OF ROY A. SCHOTLAND, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY

I. THE NEED FOR FEDERAL LEGISLATION

At the core of the state and local pension scene is a conflict of interest. That conflict is ignored in most communities now, but it promises—it does not merely threaten—much higher local taxes, or insolvency. State and local political processes could operate to correct this conflict, but will not do so without Federal disclosure requirements.

Just about the time of your last Hearings on PERISA, San Francisco's Mayor Alioto, who then was about to leave office but wanted peace for the remainder of his term, settled a dispute with his city employees by agreeing to sharply higher pension benefits. Of course an increase in current wages would boost the budget and taxes at once, but pension raises are a lovely vehicle, securing peace for the officials who agree to them, and sending the bill forward in time to some later office-holders.

Current office-holders, then, have a conflict between their obligation to avoid imposing undue future obligations on their own communities, and, on the other hand, their personal interest in avoiding political difficulties. (We do have two "buffers" or protections in many jurisdictions, which reduce the impact of the conflict of interest. First, in many States the Legislature must act before pension increases become effective. However, even where this process is in operation, it is often a rubber-stamp for agreements earlier arrived at. Second, in many systems, the employer contributions are more or less matched by employee contributions and so employees will not so freely press for increased benefits in the future when the increase means larger contributions from themselves at once. However, state and local employees' pension contributions are only half as large as the employers' contributions, and the trend is to make the employees' proportions still smaller. So relatively litt'e resistance to pension boosts can be expected from the employees. In any event, there is little or no cost to adding to those two protections the great additional protection of effective disclosure.)

Current office-holders would find it incomparably harder to mortgage away their communities' futures in order to secure their own personal political advantage, if the communities knew the simple facts about the future costs, and knew them when the commitments were being considered.

The best proof of the existence of that conflict of interest lies in the incredible information gaps which characterize state and local pension plans, as recently revealed for the first time in your Pension Task Force's Report:

Actuarial valuations.—None in last 10 years, for 25 percent of local plans, 5 percent of state plans; none for last five years, for another 15 percent of local plans, and another 20 percent of state plans.

Audits.—⅓ of all state and local plans have no annual audit (over ⅓ of the larger plans); less than half of the plans have independent annual audits, less than 40 percent of the larger plans.

Unfunded liabilities.—Estimated by your report to be between $150 and $175 billion as of 1975, but at $270 billion as of the same year, according to another

authority. So huge a range indicates not only methodological difficulties, but also acute gaps in information.

Plan descriptions.—More than ⅕ of the plans will not furnish, even to plan participants, even upon request! And only 42 percent of the local plans furnish these automatically.

Reports of employees' own contributions.—Half of the plans do not give this information to participants automatically; and over 8 percent won't furnish even upon request!

Number of plans.—Some States, like Pennsylvania, have found great difficulty in simply determining how many systems are operating; Pennsylvania apparently wins the prize, with 1,387 locally administered systems and 26 state systems. Until your report revealed the existence of about 6,630 state and local pension systems operating in the nation, the wildly erroneous figure always used, produced by the Census Bureau, was about 2,300. The existence of 4,000 previously unknown plans in itself says a great deal about the diversity and unknown weaknesses that characterize this sector.

Nor do those six categories exhaust the roster of crucial kinds of facts which are either kept secret, or are totally unknown, in so appallingly many communities. The assets of these plans are only roughly known, since most plans ignore market valuations even for marketable securities, instead showing only original cost figures; fewer than ¼ of the plans valued *any* assets on a market basis. It follows, then, that investment performance information is even rougher. Even among the largest plans, the monitoring of investment performance varies from the most sophisticated to the obsoletely simplistic. Far too many get no data (let alone disclose data) showing, one way or another, how risky was the investment portfolio. The same is true as to data comparing the portfolio's performance with comparable portfolios.

Disclosure is the best single answer toward ending other conflict-of-interest abuses, such as giving inappropriate amounts of broker-dealer commission business to a favored handful of firms, etc. It is not only self-serving politicians who want to keep state and local pension facts in the closet: it is also firms that want to exploit captive business relationships.

I hope you will ask witnesses who come before you, representing state and local plans, to answer the key questions about what their systems disclose. Let's see how plans' disclosure measures up compared with, say, the California or New Jersey state systems, which are among the very best when it comes to disclosure (and, for that matter, much else). Let's see this particularly in the case of witnesses who argue that your PERISA bill isn't needed.

Does the lack of information matter? The taxpayers and pension participants of Albany, Georgia could not be expected to protect their interests when they didn't know that this city pension fund was earning an average investment return of 1.1 percent over 11 years (in the good years, 1960–71 * * * because of a conflict abuse). The citizens of Alabama weren't aware that $22,000,000 of state pension assets were lying idle in demand deposits, until a new pension administrator came abroad in 1973. (The only information collected about this age-old abusive public subsidy for selected banks, is in last May's report by the Comptroller General, for the Senate Committee on Human Resources, dealing with fewer than 10 plans. The plans studied report what appear to be happily low demand deposits, Virginia's even being negative. But without more comprehensive and routine data, we can't be sure what is low and what is abusively high.)

Can anyone doubt that the citizens of New York City would have been better able to act to protect their solvency, if they had not been victimized by budget deceptions conceived and continued by politicians whose interests were served by concealing the facts? Yes, the truth will come out. But by the time it does, the deceivers have gone on to other posts, and the burden facing the community is more massive and more troublesome than it would have been if appropriate disclosure had been operating.

I have so much respect for the Dent-Erlenborn team's efforts in this area, and I so agree with your direction, that I trust you will allow me to register one criticism.

When Chairman Dent introduced the 1978 PERISA bill two months ago, he gave two reasons why we need Federal reporting and disclosure requirements: (1) only thus can we learn enough to decide what ought to be done with regard to funding, portability, and other aspects of such plans, and (2) only thus can

we assure our public servants the information essential to their retirement planning.

I submit that the key reason we need Federal reporting and disclosure requirements is to enable state and local political processes to operate effectively. The facts your recent report reveals, prove that we cannot wait for voluntary improvement. Indeed, as shown in a recent Coopers & Lybrand—Univ. Michigan study of financial disclosure by our cities, only about 100 of the 18,000 eligible municipalities have even considered participating in the voluntary governmental accounting, auditing and financial reporting program; over the last 30 years, only about 15 cities per year actually complied.

II. THE LEGAL BASIS FOR FEDERAL LEGISLATION

No one could question Federal authority to deal with this matter which has great impact on Federal concerns, but for one case, the 1976 5–4 decision in *National League of Cities*, 426, U.S. 833.

Even given, *NLC*, note what a "far cry" from *NLC* are the reporting, disclosure and fiduciary standards proposed in H.R. 14138. The "far cry" language itself comes from an October 3, 1978 decision by Federal District Judge Schwarzer, in *California* v. *Blumenthal*, (BNA Pension Reporter 10/23/78, p. D–1). The Judge needed only five paragraphs (in a much longer opinion dealing with intricate procedural issues before the *NLC* question could be reached) to explain and hold flatly that *NLC* and the Tenth Amendment did not free California from the Internal Revenue Code requirement to file a Form 5500, an annual information return about its pension plans.

Judge Schwarzer is the only judge who has had occasion to consider how *NLC* bears on Federal regulation of state and local pensions, but he is far from the only authority on the matter. The New York City pension funds refused to participate in the "bail out", under which the funds are investing over one-third of their assets in NYC and MAC securities, unless the funds were explicitly exempted from two Internal Revenue Code provisions. The IRC requires pension assets to be managed for the "exclusive benefit" of the pension beneficiaries, and also prohibits self-dealing. Obivously, neither the NYC fund trustees nor their counsel were willing to risk disqualification from favorable tax treatment on the far-fetched argument that under *NLC*, the Tenth Amendment bars the Federal Government from assuring compliance with the purposes underlying the grant of favorable tax treatment.

There is no doubt that not only as a condition on favorable tax treatment, but also as direct protection for other Federal concerns, the kind of provisions proposed in H.R. 14138 are constitutional.

Consider the Federal concerns. This is not a general socio-economic improvement, such as the minimum wage and maximum hour legislation at issue in *NLC*. Rather, this is a problem of state and local solvency implicating the Federal spending power. (Also, there are here Federal concerns to avoid discriminatory or arbitrary use of public funds, implicating the Fourteenth Amendment, the last section of which authorizes Congressional action.)

In fiscal 1977, the Federal Government spent about $60 billion in aid and grants to state and local governments.

In 1974 and again in 1978, the Federal Government has come to the aid of New York City, including specifically guarantees to the City's five pension funds, one of which is already verging on insolvency (the Firemen's fund).

Since 1937, the Federal Government has administered a huge previously private pension system, the railroad retirement system. In 1946 that system was coordinated with Social Security, and in 1951 that system's benefits were guaranteed to be at least equal to Social Security benefits. By means of the "financial interchange" between that system and Social Security, well over $6 billion has flowed into the Railroad Retirement Account from Social Security. And since 1974, another several hundred million dollars annually are flowing to that Account from general Federal revenues, with predictions abounding that the flow will have to increase to meet the Account's liabilities.

I agree that Congress could not let railroad employees go without the pensions promised them. But is it not even more likely that Congress would be unable to let state and municipal employees go without the pensions promised them, even if their state and local pension plans had been so under-funded, or so ill run, or both, that there would be no pension payments unless the Federal Treasury paid?

Recently, pension plans in Toledo and in Hamtramck, Michigan, have run out of funds. As we experience steadily increasing numbers of retirements of persons covered by the pension improvements of the 1960's, I fear we will see many plans run dry. Congress will be able to ignore some, but not if "some" turn into many. Now is the time to act to hold down the number of pension plan failures, lest the pressure for rescue from Federal general revenues build up. The Federal Government is the pension provider of last resort.

Another Federal concern, implicated directly and at all times even by wholly solvent state and local pension plans, is the loss of Federal tax revenues caused by deferring taxation on payments into pension plans. Such payments would be immediately taxable as ordinary income to the employees—and the investment earnings of the pension plans themselves would also be immediately taxable—but for the sound Congressional decision to defer such taxes in order to aid building assets for retirement security. The IRC "exclusive benefit" and related provisions exist to assure protection of the purposes for which favorable tax treatment is extended.

Now, some people might make the shallow argument that since the favorable tax treatment need not be extended, of course it can be extended subject to conditions. That argument is shallow in the sense that only appropriate conditions will stand up; we have a large doctrine of "unconstitutional conditions". But there is no question that conditions which do not interfere with constitutionally protected interests (e.g. the state sovereignty underlying the *NLC* decision), and which do directly further the Federal program they are part of (e.g., disclosure and fiduciary requirements to reinforce the IRC "exclusive benefit" condition), will be upheld.

It is imperative to remember that there would be no need to discuss whether the Federal Government has authority to enact something like H.R. 14138, but for the NLC decision, so we must remember the limits on that decision. Some people would argue that the 5–4 decision, involving a majority opinion joined by only four Justices, is plainly wrong and will not last. But even if one agreed that the doctrine underlying the decision is, as the dissent said, an "abstraction without substance", the decision itself has legal substance, and we must note what that substance is.

First, the majority's view that the Tenth Amendment bars Federal requirements as to minimum wages and maximum hours in state employment, was narrow. It went only to matters "essential to the separate and independent existence of the States". Only four days after *NLC* was decided, the Court unanimously upheld Federal statutory restrictions on employment discrimination in state employment. (*Fitzpatrick* v. *Bitzer*, 427 U.S. 445 (1976).)

Second, lower courts considering Tenth Amendment arguments have interpreted *NLC* narrowly in considerable variety of settings, just as Judge Schwarzer did in rejecting California's effort to avoid filing Form 5500 annually. (See, e.g., cases in your Task Force Report, p. 19 n. 16.)

Third, *NLC* invalidated legislative requirements which "operate to directly displace the States' freedom to structure integral operations", and in a manner that "directly supplants the considered policy choices of the States' elected officials and administrators".

While the *NLC* criterion of validity is not lucid, it does seem clear that mere disclosure and reporting requirements, as in H.R. 14138, would pass the *NLC* test, indeed, are a "far cry" from *NLC*. As Julge Schwarzer held, the requirement to report on Form 5500 is "no more intrusive" than the long-standing, unprotested practice by state governments of filing Federal information tax returns on their employees, and even accepting the cost burdens of withholding taxes.

In my own view, if a PERISA bill were proposed which included ERISA-like requirements regarding funding, and/or vesting, and/or portability, *then* the *NLC* issue would have some reality; but for disclosure and reporting, it has none. Similarly, with respect to the fiduciary provisions of H.R. 14138, since I believe there is no doubt whatever about the constitutionality of the IRC "exclusive benefit" provision, and since ERISA-like fiduciary provisions merely bring this Committee's wisdom to bear on assuring that pension plans are operated for the benefit of the pensioners rather than for the benefits of the operators, I submit that H.R. 14138 has zero constitutional problems.

However, to get rid of the red herring which *NLC* represents in discussion of this bill, whatever might be the case regarding Federal requirements as to funding, etc., I urge this Committee to do as did the Senate Judiciary Committee in

handling the question whether national no-fault motor vehicle accident insurance was constitutional: That Committee secured a formal Opinion Letter from Erwin N. Griswold, former Solicitor General and former Dean of Harvard Law School. (See Sen. Rept. No. 93–757, at p. 10; Hearings on No-Fault Insurance, 93d Cong. 1st and 2d Sess., 1973–4, pp. 743–894). I urge you to secure a formal opinion from such pre-eminent authorities as Dean Griswold, or Edward Levi, or other persons whose care and reputation alone will help put the *NLC* argument in its proper place.

III. WHY THE FIDUCIARY PROVISIONS OF H.R. 14138 ARE NEEDED

The first portion of this testimony makes clear why the disclosure provisions are needed. Federal disclosure requirements are not merely a necessary first step before sound legislation could occur on the further problems of funding, etc. Rather, H.R. 14138 is a step which may very well be the only Federal legislation needed, activating local political processes to protect local solvency and fair treatment of participants. (That step, by the way, furthers the concerns expressed by the *NLC* majority, as well as furthering the concerns of the dissenters.)

As for the fiduciary provisions, although the tax code has long barred self-dealing and has required plans to be run for the "exclusive benefit" of beneficiaries, ERISA had to be enacted with major provisions enlarging the guidance to fiduciaries and limits on their acts. ERISA was needed because experience had shown that the simple tax code command was inadequate. Abuses in the state and local pension plans may, by some perspectives (be less dramatic than they were in corporate and multi-employer plans, but abuses there have been, and there have been many, widespread, and persistent. Your Task Force Report refers repeatedly to a Twentieth Century Fund study which is part of a project I have chaired on conflicts of interest in financial institutions. I will not here repeat the episodes and problems so tellingly written about by that study's author, Louis M. Kohlmeier. I am pleased that Mr. Kohlmeier's study has commanded the attention I believe it deserves. (Some of that study's findings are set forth in my testimony before this Committee three years ago, Hearings on PERISA of 1975, 94th Cong. 1st Sess., pp. 123–9.)

Illinois itself provides a good example of how inadequate existing fiduciary law is. Illinois has five state plans, and 13 other "statutory" plans, such as the Policemen's Annuity and Benefit Fund for employees of cities over 500,000. Of the five state plans, only three have any explicit provision against self-dealing; the other two have nothing beyond the trustees' oath to "diligently and honestly administer the affairs of" the plan, and not "knowingly violate or wilfully permit to be violated any of the provisions of law applicable to the retirement system".

Of Illinois' 13 "statutory" local plans, seven have nothing about self-dealing (See your Task Force Report, pp. 481–2, 494-5.)

Of course the general law of trusts is applicable, but that is inadequate for three reasons: First, that body of law almost entirely involves simple trusts, as distinct from pension funds with huge numbers of beneficiaries and even large numbers of trustees and administrators; in addition, the persons holding the trustee's or administrative posts change incomparably more frequently than trustees of ordinary trusts. Second, it follows, then, that problems arise in the pension setting involving questions unresolvable under the quite general applicable trust precepts. Third, trust law requires appropriate disclosure to beneficiaries, but has not yet been extended to pension disclosure, and without adequate disclosure the beneficiaries' rights will not be enforced.

If trust law had been adequate for pension problems, ERISA not only would never have been passed, it would not even have won significant efforts toward passage.

Are state and local plans' trustees so sophisticated, and so noble, compared with the trustees of private sector plans, that they need nothing more than a general direction to do no wrong?

As a telling example of what a blank slate is found when we seek guidance in state law for the fiduciaries of most state and local pension funds, consider what a distinguished recent pension commission, Illinois' in 1977, had to say about fiduciary standards. The following is that Commission's *complete* treatment of the subject:

Fiduciary standards for trustees.—A recent federal law, namely, the "Employees Retirement Income Security Act of 1975", commonly referred to as "ERISA", mandated certain duties and responsibilities on trustees of retirement

systems operating in private industry. *Although this law applies to private industry systems, the standards and policies which it establishes could well be utilized in the management of public retirement systems.*

The term "fiduciary" may be defined to mean any trustee of a retirement system, the investment counsel, the administrator or director, or any other person having authority to direct, manage or dispose of assets of a retirement system, and to any person who may not have an appropriate title but may have a discretionary role or some responsibilities in the management, operation or direction of a retirement system.

(Report of the Ill. Public Employees Pension Laws Commission, June 30, 1977, p. 84.) (Emphasis added)

IV. PERISA and ERISA: Two commendable changes from ERISA, another which is questionable, and a fourth provision where change is needed.

I am delighted that Congressmen Dent and Erlenborn, taking heed of the experience under ERISA, have made two major simplifications in PERISA, one reducing the burden of reporting, the second re-casting the treatment of prohibited transactions so as to allow legitimate activity to go forward without the burden and delay of advance approval from an over-loaded bureaucracy.

However, the provision on fiduciaries' liability has been changed in a way which, I believe, would create a situation no one wants. I fully understand why Section 209 of H.R. 14138 creates a distinction between fiduciaries who are also government officials or employees, and other fiduciaries. (I am not questioning Section 214, which frees officials from fiduciary liability for their official acts with respect to benefit or funding levels or appropriations, acts which do not occur in their role as pension plan trustees; I entirely agree with Section 214. Rather, I am suggesting that Section 209, and surely that Section's mesh with Sections 205 and 210, need at least clarification, probably reconsideration.)

At first blush it seems reasonable, even desirable, to free the former group from the fear of personal liability, and instead render liable the employer which such person serves. The problem emerges as one thinks about how the Section 209 distinction will operate in the case of pension boards composed of both government officials or employees, and also persons outside government. Will private citizens be as willing to serve as trustees where they are protected only to the extent of their insurance, while some of their co-trustees are wholly insulated from personal liability? The problem worsens as one considers that we have significant experience of situations where abuses were engaged in by trustees who were also government officials. And the problem looms important when one notes that 42 percent of state and local pension boards include some persons from outside government; at 15 percent of the systems, persons outside government constitute more than ⅓ of the board membership; and at 34 percent of the teachers' pension systems, such persons constitute over ½ of the board membership. (Pension Task Force Report, pp. 206–7.)

I believe, as do many people, that pension boards should be both representative and knowledgeable. (See my testimony at your 1975 Hearing, *supra.*) I believe there should be some ordinary taxpayers, some private citizens sophisticated in finance, and some retirees, sitting on such boards. But even if one did not agree with that view on board composition—a view, reflected by a great many pension systems today—surely PERISA's fiduciary provisions ought not to undercut those States and localities which do want such representative boards, and which should not have to overcome Federal legal hurdles in order to fill positions on such boards.

If your hearings reveal that it is not feasible to impose personal fiduciary liability on government officials and employees sitting also as pension trustees, then I suggest that you have the Employee Benefit Administration (proposed in H.R. 14138) act is insurer of state and local pension trustees' fiduciary liability. There are enough precedents for such a step, but to me one of the most interesting is the Federal Council on the Arts and Humanities, which, under the Arts and Artifacts Indemnity Act, insures foreign art exhibits. In fiscal 1977, the Council insured 17 exhibits for $131,626,121, commercial premiums for which would have cost $1.5, making many of those exhibits unfeasible. (No claims have yet been made.) Such an insurer is clearly the lowest-cost to the economy as a whole.

I close noting a provision which I believe is inadvertently unchanged from ERISA. Section 207 of H.R. 14138 establishes a 10 percent limit on acquisition of employer securities and other employer obligations or property. In ERISA, such a provision was a clear step forward, because many corpoations had loaded their pension plans with common stock of the employer, or with real estate in sale and leaseback arrangements. Such practices rendered pension beneficiaries

more exposed to harm if the employer failed, (or even failed to prosper). Thus, in ERISA, the 10 percent limit improved the soundness of many plans.

But in the state and local pension setting, almost no plans hold substantial employer-related assets. Consider these figures:

Percentage composition of assets of State and local retirement systems by type of investment: 1950–77

State and local obligations:	
1950	31.3
1960	18.1
1970	3.3
1975	2.4
1977	2.3

Source: Federal Reserve Board flow of funds accounts.

Even that decline would be sharper but for recent events in New York City, whose very large pension fund assets represent so considerable a proportion of the aggregate figures above. Consider:

HOLDINGS OF NEW YORK CITY SECURITIES BY THE NEW YORK CITY RETIREMENT SYSTEMS COMPARED TO TOTAL ASSETS, 1952–53 TO DECEMBER 1977

Fiscal year	Total assets	Holdings of New York City securities	Holdings as a percent of assets
1952–53	$1,290,603,608	$965,805,507	74.8
1953–54	1,476,140,081	1,074,066,777	72.8
1954–55	1,671,044,419	1,155,577,094	69.2
1955–56	1,861,441,938	1,283,133,208	68.9
1956–57	2,074,628,554	1,462,110,463	70.5
1957–58	2,294,397,280	1,642,076,229	71.6
1958–59	2,527,228,010	1,824,347,290	72.2
1959–60	2,769,501,069	1,942,046,400	70.1
1960–61	3,008,417,255	1,976,600,591	65.7
1961–62	3,241,134,436	1,859,618,739	57.4
1962–63	3,512,079,017	1,690,811,238	48.1
1963–64	3,804,965,234	1,537,952,193	40.4
1964–65	4,141,769,389	1,449,402,671	35.0
1965–66	4,516,349,361	1,447,518,659	32.1
1966–67	4,920,773,156	1,446,861,222	29.4
1967–68	5,249,734,778	1,413,921,181	26.9
1968–69	5,481,329,731	1,361,573,402	24.8
1969–70	5,710,663,904	1,270,575,359	22.2
1970–71	5,960,246,051	1,100,779,087	18.4
1971–72	6,247,773,365	1,026,034,455	16.4
1972–73	6,438,818,893	386,673,959	6.0
1973–74	7,264,790,701	330,733,900	4.6
1974–75	7,725,035,898	330,731,900	4.3
December 1977	9,516,965,766	3,043,406,000	32.0

Source: Annual Report of the Comptroller of the City of New York, respective years.

State and local pension trustees and administrators have fought for a generation to withstand intense local pressures for buying local muncipal securities and other employer-related investments. To their enormous credit, the pension people have almost completely won this battle. Even in New York City, Congress has now imposed statutory safeguards on the amount and the terms of local municipal (and municipal agency) securities which the pension funds there can hold. (See my testimony before the Senate Finance Committee, March 8, 1978; Sen. Rpt. No. 95–956, Sept. 13, 1978; and the just-enacted H.R. 4007, 95th Cong. 2d Sess.)

I am concerned that if Congress authorizes state and local plans to hold up to 10 percent of their assets in local municipals, it will be harder for the trustees and administrators to hold the line they have fought for so long and so well. It is only a partial answer to say that even the 10 percent allowable must be "prudent". Many local securities pay interest rates not far from taxable securities; and the relative riskiness of securities is too arguable for us to rely wholly upon "prudence" as the sole safeguard against undesirable investments. I submit that your bill should go along with the gains of the last generation in state and local pension investing. Either bar such holdings or else adopt a low limit which reflects actual experience, e.g., about 2.5 percent of assets, perhaps subject to waiver in extraordinary circumstances.

Questions about fiduciary conduct in state and local pension funds

(Prepared by a state pension fund investment officer, during discussions with R. A. Schotland)

A. Administration

1. Are the members of our investment board or pension fund board appointed by public officials? Are they elected by the public?

2. Do the qualifications for membership on the investment board or pension fund board fail to include investment expertise?

3. Is the investment staff for a pension fund chosen for any reason other than their investment expertise?

4. Do the members of the pension fund board or any investment board have a material relationship with any bank, broker or corporation or person which transacts business with the pension fund or whose securities are held by the fund?

5. Does any member of the investment staff for the pension fund have any material relationship with any bank, broker, corporation or person who transacts business with the pension funds?

6. Is any member of the investment board, pension fund board, investment advisor or investment staff politically active?

7. Does the selection of money managers or investment advisors favor those residing within the state or those who are politically active?

8. Is the selection of other services, such as custodial relationships, computer services, performance measurement studies etc. made on any basis other than a measurement of the best service for the best price?

B. Short-term securities transactions

1. Are purchases of treasury bills and notes, U.S. Government agency securities and commercial paper effected in any way other than through competitive bidding? If your pension fund has eligibility criteria for selecting vendors or bidders, do these criteria favor in-state vendors in terms of rate, the amount of securities that can be purchased, less stringent financial qualifications or by any other means?

2. Are purchases of Certificates of Deposit limited to in-state banks? Do the qualifications for any "approved list" favor in-state banks? Are in-state banks provided with a rate advantage? Are in-state banks required to meet less stringent delivery and collateral rules than out-of-state banks? Does the fund purchase certificates of deposit at times when rates for treasury bills, U.S. agency obligations or commercial paper are comparable or superior?

3. Does the investment program favor the purchase of bankers' acceptances from in-state banks?

C. Transactions in long-term bonds

1. When bonds are purchased from a syndicate, is the allocation of the order made on any basis other than the financial services provided by the brokerage firms to the pension funds? Are in-state firms favored?

2. When bonds are purchased in the secondary market, is any method other than competitive bidding employed? If not, do the criteria for selecting the broker include anything other than an evaluation of financial services? Are in-state brokers favored?

3. In a bond swap, is any method employed other than competitive bidding on both sides of the transaction? If not, do the criteria for broker selection include any factor other than financial services? Does the analysis and documentation for the swap include a justification for the swap based on a review of available market prices for such a transaction? Are in-state brokers favored?

4. Does the bond investment program favor investment in in-state corporations or utilities?

D. Transactions in mortgages

1. Are purchases of in-state mortgages favored over out-of-state mortgages? Is any rate advantage provided for mortgages on properties within the state?

2. Are mortgage brokers, mortgage bankers, commercial bankers, mortgage servicing organizations, and corporate or individual mortgagors favored in any way over such out-of-state entities?

3. Are GNMA's purchased or sold through any method other than competitive bidding?

E. Transaction on private placements

1. Does the pension fund favor in-state investment in private placements of corporate securities?

2. Does the pension fund take all of a private placement, either alone or in combination with other pension funds administered within the state? Does it act as lead purchaser? Does the fund ever act as lender of last resort? Do the rate and terms offer an advantage over what might be available in the market place? Is the appointment of council for the purchaser made solely on the basis of merit and price?

F. Transactions in equities

1. Do you or your money managers give any preferences for the purchase of equities of in-state corporations? Is the choice of stocks on any basis other than a prospective maximization of total financial return to the pension fund?

2. Do you or your money managers favor using in-state brokerage firms for executing stock orders?

3. Do your equity investment criteria include consideration of employment within your state, taxes paid within your state or other indications of business within your state?

4. Do you receive any guidance from politically elected officials in voting corporate proxies?

5. In the voting of proxies, do you give weight to moral or social concerns?

6. When stocks are purchased from syndicates, is the allocation of the order made on any basis other than the financial services provided by the brokerage firm to the pension funds?

G. Cash balances

1. Are cash balances of pension funds maintained in custodial banks on any basis other than the lowest cost for services rendered to the pension funds?

2. Are balances of the pension funds used to pay for services rendered to parties other than the pension funds?

This is not meant to be an all inclusive list, nor do I believe that a "yes" answer is necessarily indicative of a conflict of interest.

Mr. SCHOTLAND. At the core of the State and local pension scene is a conflict of interest. That conflict is ignored in most communities today but it promises—it does not merely threaten—much higher local taxes or else insolvency. State and local political processes could operate to correct this conflict but will not do so without Federal disclosure requirements.

Just about the time of your last hearings on PERISA, San Francisco's Mayor Alioto, who then was about to leave office but wanted peace for the remainder of his term, settled a dispute with his city employees by agreeing to sharply higher pension benefits. Of course an increase in current wages would boost the current budgets and taxes. But pension raises are a lovely vehicle, securing peace in the official's own time and sending the bill forward to later officeholders.

The fact that in many States the legislature must act before a pension increase becomes effective serves as a valuable buffer or insulator. But it is only part of the solution.

Current officeholders would find it incomparably harder to mortgage away their communities' futures in order to secure their own personal political advantage if the communities knew the simple facts about the future costs, and knew them when the commitments were being considered.

The best proof of the existence of a conflict of interest in the State and local sphere lies in the incredible information gaps revealed for the first time by your Pension Task Force's report this year.

Actuarial valuations: None in the last 10 years for 25 percent of the local plans, 5 percent of State plans; none for the last 5 years for another 15 percent of local plans, 20 percent of State plans.

Audits: Less than half of the plans with independent, annual treatment.

Unfunded liabilities: Staggering both in amount and uncertainty about the range. We are just $120 or so billion one way or the other.

Plan descriptions and reports of employees' own contributions: Refused to participants even upon request, I was astounded to find from your report, as I am sure other readers will be too.

You found almost three times as many plans as everyone had thought existed. What could say more clearly than that simple discovery by your staff, about the diversity and unknown weaknesses that characterize this sector.

Those six categories do not exhaust the roster of crucial kinds of facts which are either kept secret or are literally completely unknown in so appallingly many communities. The assets of the plans are only roughly known, since literally most plans ignore market valuations even for marketable securities, instead showing only original cost figures.

It follows that investment performance information is even cruder.

Disclosure is the best single answer toward ending other conflict-of-interest abuses, such as giving inappropriate amounts of broker-dealer commission business to a favored handful of local firms, and so forth. It is not only self-serving politicians who want to keep State and local pension facts in the closet. It is also firms that want to exploit captive business relationships.

Congressmen Simon and Erlenborn, I hope you will ask witnesses who come before you representing any State and local plans to answer the key questions about just what their systems do disclose. Let's see, if they are not prepared in testimony to answer such questions then by answers in subsequent appendices to testimony, just how their plans' disclosure measures up compared with, say, the California or New Jersey State systems' disclosure, which I single out as not necessarily the best but as known to me to be among the best.

Let's see particularly in the case of witnesses who argue that PERISA isn't needed.

Does the lack of information matter? The citizens of Alabama didn't know that $22 million of State pension assets were lying idle in demand deposits, no interest, until a new pension administrator came aboard in 1973.

Can anyone doubt that the citizens of New York City would have been better able to protect their own solvency if they had not been victimized by budget deceptions conceived and continued by politicians whose interests were served by concealing the facts? Yes; the truth will come out. But by the time it does, the deceivers have gone to other posts and the burden facing the community is both more massive and more troublesome than if it were known from the beginning.

I have so much respect for what the Dent-Erlenborn team have done in the ERISA and now in the PERISA area, and I so much agree with your directions that I hope I may register one small criticism.

When Chairman Dent introduced the PERISA bill 2 months ago, he gave two reasons why we need Federal reporting and disclosure. One, only thus can we learn enough to decide what should be done with regard to funding, portability, investing and so forth. Two, only

thus can we assure our public servants the information essential to their retirement planning.

I submit those are not the main reasons. The key reason why we need this bill is to get Federal reporting and disclosure so as to enable State and local political processes to operate effectively to protect their own communities. The facts your recent report reveals prove that we cannot wait for voluntary improvement.

In the second portion of my testimony I deal with the legal basis for Federal legislation. There would be no need to deal with this but for the *National League of Cities* decision. Whether or not one likes the decision, it is there. But I submit with complete confidence that there is no real question, as distinct from a red herring question, about Federal authority to require disclosure reporting and fiduciary standards.

There might be a question if the bill included, as it does not, funding, vesting, portability, and so forth. I set forth several pages explaining why there is no question about the constitutionality, starting with the decision only last month rejecting California's constitutional argument of immunity from Federal reporting requirements.

However, to get rid of the red herring which *National League of Cities* represents in discussion of the bill, a device that can be used and will be used to confuse the discussion of the bill, I urge your committee to do as did the Senate Judiciary Committee in handling the very different question of whether national no-fault motor vehicle accident insurance was constitutional. That committee secured a formal opinion letter, about 150 pages in length, from former Solicitor General, former Dean of Harvard Law School, Erwin Griswold. I urge you to secure a similar formal full opinion from such a pre-eminent authority as Dean Griswold or Illinois' own Edward Levi or other persons whose care and reputation alone will put the *National League of Cities* argument in its proper place, which is outside the discussion of this bill.

Why are the fiduciary provisions of this bill needed? Although the Tax Code has long barred self-dealing and has required plans to be run for the exclusive benefit of beneficiaries, ERISA had to be enacted with major provisions enlarging the guidance to fiduciaries and limits on their acts. ERISA was needed because experience had shown that the simple Tax Code command was inadequate.

Abuses in the State and local pension plans may, by some perspectives, be less dramatic than they were in the private sector plans. But abuses there have been, and many, widespread, and persistent and costly.

Your task force report refers repeatedly to a Twentieth Century Fund study, which is part of a project I have chaired on conflicts of interest in financial institutions. I will not here repeat the episodes and problems so tellingly written about by that study's author, Lou Kohlmeier. I am pleased that the study has commanded the attention that I believe it deserves.

Illinois itself provides a good example of how poor, how inadequate, existing fiduciary law is. Illinois has 5 State plans and 13 other so-called statutory plans, such as the Policemen's Annuity and Benefit Fund for employees of cities over 500,000. Of the five State

plans, only three have any explicit provisions against self-dealing; the other two have nothing beyond the trustees' oath.

Of Illinois' 13 statutory local plans, 7 have nothing about self-dealing. I am referring only to the most simple prefatory direction to "do no wrong." And they don't even have that. I submit that even if they had that, we wouldn't be very much advanced. The point is, the problem hasn't been thought about. The direction to the fiduciaries, the help to tell them what to do and what not to do, isn't there.

That is why we need this kind of act, because State and local plans trustees are neither so sophisticated nor so noble compared with private sector trustees, that the State and local people need nothing. They need something. This bill will start the road.

The last portion of my testimony deals with four contrasts between this bill and ERISA. I am delighted that the sponsors have taken heed of the experience under ERISA and have made two major simplifications, one reducing the burden of reporting and the disclosure burden and the second turning around the prohibited transaction treatment so that legitimate activity can go forward without the burden and delay of advance approval from an overloaded bureaucracy.

Those two changes alone, if they had been made in ERISA, whether or not they should have been made there, I think would enormously change general attitudes toward ERISA. So I think when people talk about what large problems there have been under ERISA, that needs to be taken with very heavy salt, in light of the changes that I think have been so wisely made here.

However, the provision on fiduciaries' liability in this bill has been changed in a way which I believe creates a situation that no one wants. I understand why your section 209 creates a distinction between fiduciaries who are also Government officials or employees, and the other fiduciaries. At first blush it seems reasonable, even desirable, to free the former group from the fear of personal liability and instead render the State or local employer which such person serves as the liable party.

The problem emerges as one thinks about how the section 209 distinction will operate in the case of pension boards composed of both Government officials or employees on the one hand, and also persons outside Government.

Will private citizens be as willing to serve as trustees where they are protected only to the extent of their fiduciary insurance, while some of their co-trustees are wholly insulated from personal liability?

The problem worsens as one considers that we have significant experience of situations where abuses were engaged in by trustees who were also government officials. And the problem looms massive when one notes that 42 percent of State and local pension boards include some persons from outside government; at 15 percent of the systems, persons outside government constitute more than a third of the board membership and at 34 percent of the teachers' pension systems, persons outside constitute over one-half of the board membership.

Surely PERISA's provisions ought not to undercut those States and localities which want boards with a mingled representation on the board. Surely State and local systems ought not to have to overcome Federal legal hurdles in order to fill positions on those boards.

If your hearings reveal that it is not feasible for one reason or another to impose personal fiduciary liability on government officials and employees who sit also as pension trustees, then I suggest that you have the Employee Benefit Administration proposed in this bill act as the insurer of State and local pension trustees' fiduciary abuses. We have a number of highly pertinent precedents, legislative precedents, for such a step. I also think it will be far less costly overall.

I close noting a provision which I believe is inadvertently unchanged from ERISA. Section 207 of H.R. 14138 establishes a 10-percent limit on acquisition of employer securities and other employer obligations or property. In ERISA the 10-percent provision was a clear step forward because many corporations had loaded their pension plans with common stock of the employer or with employer real estate in sale and leaseback arrangements. Such practices rendered pension beneficiaries more exposed to harm if the employer failed, or even failed to prosper. Thus in ERISA the 10-percent limit improved the soundness of many private sector plans.

But in the State and local pension setting, almost no plans hold substantial employer-related assets. Consider these figures: in 1950 this sector as an aggregate held 31 percent of its assets in State and local securities. In 10 years it was down to 18 percent, by 1970 down to 3.3 percent, by 1975 down to 2.4, 1977 to 2.3.

The bill proposes 10 percent. And note, that 2.3 percent would be even lower but for the events in New York.

I have on page 16 what I think is a dramatic table showing that from 1952 until 1975, New York City's five local pension funds came down from three-quarters of their assets in New York City securities, to 4.3 percent of their assets. Then of course a rather unfortunate set of events occurred. New York's funds are so large, proportionate to the universe as a whole, they alone account for a fair bit of that 2.3 percent in 1977.

State and local pension trustees and administrators have fought for a generation to withstand intense local pressures to buy local municipal securities and other employer-related investments. To their enormous credit the pension people have almost completely won this battle. Even in New York City, Congress has now imposed statutory safeguards on the amount and the terms of local municipal and municipal agency securities which the pension funds there can hold.

I know Congressman Erlenborn would have liked even further safeguards, and I share that position with him. But I think we do have an important precedent establishing that there is a point which is too far. Our difference perhaps with the New York City people would be where that point lies.

I am concerned that if Congress authorizes State and local plans to hold up to 10 percent of their assets in local municipals, it will be harder for the trustees and administrators to hold the line they have fought for so long and so well and so successfully.

I submit that your bill should go along with the gains of the last generation in State and local pension investing; and either bar such holdings or else adopt a low limit, far from 10 percent, which reflects the actual current state of affairs so that we don't go backwards. For example, a limit of about 2½ percent of assets instead of 10 percent, perhaps subject to waiver in extraordinary circumstances.

Thank you very much, Congressmen.

Mr. SIMON. Thank you.

If I may take up on your final point, you say "perhaps subject to waiver in exceptional circumstances." The New York City situation obviously is what we are all thinking about. How do we make such a waiver? How do we move along the lines you are suggesting without imposing a burden on New York City?

Mr. SCHOTLAND. Congressman, I think the story of the original legislation exempting New York City funds from the Tax Code, the exclusive benefit provision and self-dealing provision and then because it expired this past June, the reenactment in October for the next 4 years, really constitutes the answer to that.

The original 1975 legislation authorized the Secretary of the Treasury to safeguard the Federal taxpayer concerns. He went along, I am sorry to say, with a great watering down of the protection in the original 1974 agreement between the city, MAC, the funds and the banks. The watering down occurred in December of 1977. That took out a contractual commitment to steadily reduce the amount and level of employee securities that would be held by the funds. They took out a contractual commitment to limit the maturities to 10 years. They took out a balanced budget commitment. The new legislation puts those back in. They had been in the House Ways and Means Committee report. They hadn't been in the statute. Now it is in the statute. Unfortunately, they are allowed to go up to 40 percent of their assets, which is higher than the present holdings, around 35 percent.

But they are committed by this act to coming down by 3 years from now to only 30 percent of their assets. Senator Proxmire and the unanimous Banking Committee had said: "Let them go. Let them keep going." But Congress has said, "No, more than 30 percent is too high. We have got to get down to that as fast as we can."

So I think it is a matter of the proportions, the terms, the length of maturity. I would be willing to buy any amount of New York City paper I could afford if it had a 30-day maturity on it. But I sure wouldn't want to take 30-year paper. I think the question has to be to write in the kinds of standards we have now in the New York City situation and to delegate to the Secretary of the Treasury, the high tax official.

Mr. SIMON. You used the figure of 35 percent. We have 32 percent.

Mr. SCHOTLAND. It rose.

Mr. SIMON. It has risen.

One other item you mentioned that intrigued me. Incidentally, your testimony is very solid, substantial and I appreciate it.

Mr. SCHOTLAND. Thank you.

Mr. SIMON. You mention a number of States that have this buffer of approval. Do you have any idea how many States have that?

Mr. SCHOTLAND. I would have to defer an answer. As best I recall that, I remember that being in the Pension Task Force report. Perhaps Dr. Winklevoss and Professor McGill would have specific answers on that. It is only a buffer though. The question is how much is the legislature willing to go along. Of course, if it is the State employees it isn't very much of a buffer at all. It is a better buffer for the local employees.

We have another buffer in the fact that in many of the plans there are employee contributions. They may not want to see a great increase in benefits if it means a slight decrease in takehome. But that is only a substantial portion of the plans, far from all. If I recall it is around a half. That evidently is going down, that is, fewer of them are going on employee contributions.

Mr. SIMON. Mr. Erlenborn.

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

Mr. Schotland, thank you for your testimony. I would like to go into it much more deeply than I think we have time for this morning.

I am pleased you have raised the issue as to the constitutionality of Federal legislation in this area, and pleased about your conclusion.

I would like to have unanimous consent to introduce into the record, following Professor Schotland's testimony, this opinion of the Library of Congress Congressional Research Service, American Law Division, relative to the constitutional issues involved in the imposition of fiduciary activity restrictions and liability on State and local governments with regard to their pension plans.

Mr. SIMON. That will be entered in the record.

[The material referred to above follows:]

THE LIBRARY OF CONGRESS,
CONGRESSIONAL RESEARCH SERVICE,
Washington, D.C., October 16, 1978.

To: Task Force—Welfare and Pension Plans, House of Representatives.
From: American Law Division.
Subject: Constitutional Issues Involved in the Imposition of Fiduciary Activity Restrictions and Liability on State and Local Governments with Regard to Their Pension Plans.

This memorandum is in response to your recent inquiry as to whether any special constitutional questions may be involved under the provisions of H.R. 14138, 95th Congress, 2d Session, which would impose fiduciary activity restrictions and responsibilities upon State and local governments with regard to their own pension plans, and would impose liability on such governments and certain of their employees for damages and injunctive relief if provisions of the bill should be violated. The effect of H.R. 14138 if enacted would be to establish comprehensive standards of conduct, responsibilities and obligations for fiduciaries of State and local public employee pension benefit systems under federal control, and would provide for appropriate remedies, including damages and injunctive relief, including access to Federal courts.

The most relevant decision by the Supreme Court on this question is *National League of Cities* v. *Usery*, 426 U.S. 833 (1976). The holding in this case is very briefly to the effect that the 1974 amendments to the Fair Labor Standard Act which extended minimum wage and maximum hour provisions to almost all employees of States and their political subdivisions were unconstitutional in that they did not comport with the federal system of government embodied in the constitution which guarantees to the States the freedom to structure their integral operations in areas of traditional government functions.

Initially, it is to be noted that the Fair Labor Standards Act considered in *National League of Cities* involved the exercise of authority by the Congress under the Commerce Clause of Article I of the Constitution. 426 U.S. at 841. Similarly, H.R. 14138 would be an exercise by the Congress of authority granted by the Commerce Clause as well as by Section 5 of the Fourteenth Amendment. This is made clear in its Section 2(b), where its purposes, to protect interstate commerce and to prevent deprivations of rights without due process of law and denials of equal protection of the laws, are cited. Thus, H.R. 14138 must be considered in the light of *National League of Cities*.

In *National League of Cities*, four justices joined in the opinion of the Court, Mr. Justice Blackmun joined in the opinion of the Court with a separate statement of his understanding, and four justices dissented. It is necessary, therefore, to consider not only the holding of the Court but the reservations of Mr. Justice Blackmun in an attempt to assess the impact of the holding.

The principal opinion of the court notes that there are attributes of state sovereignty attaching to every state government which may not be impaired by Congress, even in the exercise of authority expressly granted to the Congress by the Constitution, since one of the essential characteristics of the federal system established by the Constitution is the continued existence and independent authority of the States. Thus, Congressional power may not be exercised in a fashion that either impairs the States' integrity or their ability to function effectively within the federal system, materially interferes with the performance of functions essential to separate and independent existence of the States, or operates directly to displace the States' freedom to structure integral operations in areas of traditional government functions. The opinion of the Court then proceeds to consider the effects in these areas of the minimum wage and maximum hour provisions of the Fair Labor Standards Act as applicable to State and local government employees. Following an enumeration of several of these effects, the opinion concludes that the provisions of the statute have a significant impact on the functioning of the governmental bodies involved, in some areas resulting in forced relinquishment of important governmental activities, and in others altering or displacing various state policies and decisions regarding the manner in which the State will structure delivery of governmental services or arrange its affairs. Therefore, since these impacts are "significant" and "direct," the provisions of the Act which affect state employees are not within the authority of Congress granted by the Commerce Clause. The opinion does not attempt any definition of impacts of this nature which may be "significant" or "direct."

Mr. Justice Blackmun's opinion, which is essential to give the court the majority required for a controlling decision, states his view of the opinion of the four justices with whom he concurs. In his view, that opinion adopts a balancing approach, and does "not outlaw federal power in areas such as environmental protection, where the federal interest is demonstrably greater and where state facility compliance with imposed federal standards would be essential." 426 U.S. at 456. The Justice then goes on to state that "With this understanding on my part of the Court's opinion, I join it." *Id.* These statements are most significant for in refusing to join the opinion of the plurality to the extent that it might be read to require quantitative, non-balancing decision of the impact upon state sovereignty of laws enacted by Congress under an express grant of power, Mr. Justice Blackmun has effectively altered the controlling quality of that opinion. In other words, his reservation in joining the opinion of the plurality denies to it a majority insofar as it might be read as going beyond his reservation.

The issues then posed for consideration are whether the requirements of H.R. 14138, if enacted, would have significant and direct impacts upon the functioning of the governmental bodies affected, and whether such impacts are demonstrably greater or lesser than the federal interests which underlie the proposed legislation. The federal interests are set out in some detail in Section 2(a) of the bill, and are, if supportable by evidence, of considerable substance. On the other hand, the impacts which will be felt by the State and local governments if the proposed legislation is enacted would principally consist of requirements for greater safeguards for pension plan assets, more extensive disclosure to participants of information relating to their plans, assumption of more exacting fiduciary responsibilities, and less unfairness in the administration of the plans. These might arguably be subsumed under a characterization of fair and honest business practices. Although these impacts may involve increased costs in dollars to the State and local governments affects, it is doubtful that they would even approach the significant costs which were found to be resultant of the statute considered in *National League of Cities*. It would appear, therefore, that the severity and pervasiveness of the impacts of H.R. 14138 would be far less than those noted in *National League of Cities* while the relative weight of federal interests would be not less than those involved in the Fair Labor Standards Act which was considered in that case. Therefore, it is arguable that the enactment of H.R. 14138 would be a valid exercise in this context of the power of Congress granted by the Constitution.

This does not exhaust the inquiry, however. The Eleventh Amendment to the Constitution provides,

"The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizen of another State, or by Citizen or Subjects of any Foreign State."

In this connection, it is to be noted that H.R. 14138 would grant district courts of the United States jurisdiction of civil actions under the proposed legislation.

The Eleventh Amendment has been held to afford the States a shield of sovereign immunity against federal judicial action which will be effective unless it is waived by the State. *Parden* v. *Terminal Ry. Co.*, 377 U.S. 184 (1964). H.R. 14138, however, would present this issue: As against this Constitutional shield of immunity, may Congress exercise powers expressly granted to it by the Constitution or amendments thereto to authorize federal courts to entertain actions against a State or its local governments. This matter was recently considered in the case of *Fitzpatrick* v. *Bitzer*, 427 U.S. 445 (1976). There, the conflict was between the Eleventh Amendment and the enforcement power granted to Congress under Section 5 of the Fourteenth Amendment. The statute in issue, which had been enacted under such Section 5, authorized federal courts to award money damages in favor of private individuals against a state government found to have subjected that person to employment discrimination on the basis of race, color, religion, sex or national origin. The Court held that:

"The Eleventh Amendment, and the principle of state sovereignty which it embodies, . . . are necessarily limited by the enforcement provisions of § 5 of the Fourteenth Amendment . . . When Congress acts pursuant to § 5, not only is it exercising legislative authority that is plenary within the terms of the constitutional grant, it is exercising that authority under one section of a constitutional amendment whose other sections by their own terms embody limitations on state authority. We think that Congress may, in determining what is 'appropriate legislation' for the purpose of enforcing the provisions of the Fourteenth Amendment, provide for private suits against States or state officials which are constitutionally impermissible in other contexts." 427 U.S. at 456.

H.R. 14138, as noted above, is proposed legislation to enforce the provisions of the Fourteenth Amendment due process and equal protection clauses, and is therefore arguably authorized under Section 5 of that Amendment. Thus, so long as the Congressional intent to make States amenable to suit in federal court for violations is specifically addressed by the legislation in question (see *Employees* v. *Department of Public Health and Welfare*, 411 U.S. 279 (1973)), which is, of course, the case with respect to H.R. 14138, the Eleventh Amendment would appear to present no constitutional obstacle to the grant of jurisdiction to federal courts in that bill.

In summary, it would appear that the proposed legislation in H.R. 14138 does not impermissibly impair the States' ability to function effectively within the federal system or encroach upon the shield of immunity granted to the States by the Eleventh Amendment.

MURL A. LARKIN,
Legislative Attorney.

Mr. ERLENBORN. I might just summarize this paper by saying that the legislative attorney who prepared this, Murl A. Larkin, says in the final paragraph:

In summary it would appear that the proposed legislation, H.R. 14138, does not impermissibly impair the state's ability to function effectively within the federal system or encroach upon the shield of immunity granted to the states by the Eleventh Amendment.

So it is the opinion of this attorney at least, representing the Library of Congress, that legislation in this area would be constitutional, even in light of the *National League of Cities* v. *Usery* decision.

I think this is a subject that should be addressed by as many witnesses as possible during the course of these hearings.

I appreciate your recommendation that we get additional authoritative opinions from people of stature in this area.

Mr. SCHOTLAND. Congressman, may I suggest that Federal District Judge Schwarzer's decision in *California* v. *Blumenthal*, if it is not substantially incorporated in that memorandum, you might wish to add it to the record. I would request that you do. The last five para-

graphs of his decision, the bulk of his decision, deals with Federal jurisdictional and procedural questions that he had to handle before he could get to the 10th amendment issue. The 10th amendment issue I think is dispositively handled by him, at least as to form 5500 filing requirements, in only five paragraphs. I think that belongs in the record.

Mr. SIMON. If my colleague will yield, I think your suggestion of getting someone of the stature of Dean Griswold to provide such an opinion I think would be a real plus in this area.

Mr. SCHOTLAND. It should be noted that after Dean Griswold's letter the American Trial Lawyers Association got an opinion letter from a lesser but still very distinguished constitutional law teacher. But I think the issue really was stilled once the Griswold letter was in. I think people said, "It looks fairly clearly constitutional. Let's go back to the legislative merits."

Mr. ERLENBORN. Let me get to one of the issues that you raised in your testimony this morning about the liability of elected State officials as fiduciaries, in the proposed PERISA. I might admit to being one who very jealously guarded the rights of elected officials in this area, contesting with staff to a great extent during the drafting of PERISA. But it appeared to me it is not unconstitutionally wrong to say, for instance, that an elected State representative or State senator in voting on legislation to establish the terms and conditions of the plan was therefore a fiduciary and could be held personally liable.

I really think it is difficult or impossible for us to impose personal liability upon a constitutional State official, elected official, in the exercise of his official authority. Would you address that?

Mr. SCHOTLAND. I agree with that. Perhaps I misread the section; or perhaps it needs to be a little more pointed so it doesn't get misread; or perhaps I read it rightly.

I agree with you as to their voting. I am troubled if this section draws a line between their liability once they are sitting on the pension system board and the liability of other people sitting on that board.

Mr. ERLENBORN. I guess our problem here is to in some way either redefine "fiduciary" in these cases so that acting in their official capacity they are not acting as fiduciaries or to have liability attach to some fiduciary activities where it does not to others. It might be just a matter of drafting this very carefully.

The original provision was to say that all fiduciaries would be held personally responsible. I don't think a Governor signing the bill or a legislator casting a vote should be subject to that personal liability.

Mr. SCHOTLAND. With that I concur 100 percent. No question at all. Maybe you should redefine "fiduciary" to cross out the votes of the legislators or the action of the Governor, but to include their actions in the capacity of board member.

Mr. ERLENBORN. I think we will have to turn some more attention to that before we finally enact PERISA early next year.

Mr. SCHOTLAND. I think so. I submit that the problem with fiduciary insurance is one of such costliness that serious consideration ought to be given to what will for society as a whole be a very low-cost proposition, which is Federal fiduciary insurance of the State and local plans.

Mr. ERLENBORN. Under the PERISA proposal we do leave each State the option of acting in this area if they so desire. They can provide at the State level insurance for the State and local public employee fiduciaries.

I am also pleased with your comments relative to investment in the employer's securities. We were tracking ERISA in making that 10-percent limitation. I am not certain we perceived the trap we were falling into. I know that I didn't believe we might be inviting investment in the employer's securities. The general feeling is that nontaxable public securities are by and large a very bad investment for any public employee pension plan. We ought not entice them into making such investments.

Mr. SCHOTLAND. Congressman, you may have witnesses who will say; "Leave the 10-percent figure because we still have the prudence standard." But I know, for example, one of the largest State systems has had to go along with intense pressure to lend money on a relatively short-term basis to that system's State government. And they were able to get the State to agree to prime or a quarter percent over prime. So the tax-exempt rate doesn't impair their position. They still wish they weren't doing it because it is short-term and they feel they could make better investment use of the funds.

When I discussed this with a couple of State pension fund investment officers recently—I of course have no way of speaking for them—but they did feel the 10-percent limit will take away a safeguard they have. They will be told: "Look, Congress said you can go to 10 percent. You are trying to be holier than Congress."

Maybe we should have an explicit limit rather than a flat bar. But I think something like 2½ percent, on which we have something to say why we put it there, would at least avoid a step back.

Mr. ERLENBORN. I suppose it could be argued that the exclusive benefit provision of the Internal Revenue Code also prohibits such investments. But the enactment of this may color the judgment as to the interpretation of the exclusive benefit Internal Revenue provisions.

Mr. SCHOTLAND. Precisely. And even if the State and locals hadn't thought they had to worry about this tax code, surely the corporate and multiemployer plans knew they did. We know many of them were way above 10 percent. So I think with all respect to the tax enforcers the simple exclusive benefit provisions are a little bit general.

Mr. ERLENBORN. Talking about the tax code, we found in our studies that very many public employers felt that their plans automatically were tax qualified because they were public and they had not sought qualification under the code.

I might point out for those interested that PERISA as proposed will extend automatic tax qualifications in the manner that they had felt they were entitled to in the past but did not actually enjoy. Of course there is the requirement that they comply with PERISA to maintain that tax qualification.

Mr. SCHOTLAND. I am glad, Congressman, that you brought that up because I think the record should show that Senator Stone's effort in the last Congress, which started out as an effort to exempt the State and locals from the form 5500 and qualifications requirements, turned around and said that they should report and will be subject to only

one or two conditions. When I heard the one or two conditions, I said: "That is PERISA." That is, the leading proponent of removing the tax code coverage I think has come a long way toward exactly where this bill is.

Mr. ERLENBORN. Thank you very much.

Mr. SIMON. Thank you, Mr. Schotland. We appreciate your testimony.

Mr. SCHOTLAND. Thank you, Congressman.

Mr. SIMON. I would like to call on an old friend, Senator Robert Egan. I understand Roy Baker and Al Weinberg will be testifying with him or will be accompanying him.

Mr. EGAN. Al Weinberg.

Mr. SIMON. Al Weinberg. All right.

Mr. EGAN. He is the foremost authority on pensions in Illinois.

Mr. SIMON. I would hardly dispute that.

Mr. EGAN. To take advantage of his expertise I brought him with me.

Mr. SIMON. I might mention that Senator Egan is the chairman of the Illinois Pension Laws Commission.

[The prepared statement of Hon. Robert Egan follows:]

PREPARED STATEMENT BY SENATOR ROBERT J. EGAN

My name is Robert J. Egan. I am a member of the Illinois State Senate and appear before your committee today in the capacity of Chairman of the Illinois Public Employees Commission which is a legislative commission whose membership is composed of five public members, five members from the Illinois Senate and five members of the Illinois House of Representatives. With me today, is Mr. A. A. Weinberg, consulting actuary of the Commission.

The Illinois Public Employees Pension Commission was created in the year 1945. The Commission has an Executive Director and three consulting actuaries. Its purpose is to conduct a research study of public employee retirement provisions and formulate policies for standards in Illinois on this subject for the information and guidance of the Governor and the General Assembly.

The Commission began as an interim legislative body. It continued in that status until 1959 when it was made a permanent agency and is now an integral part of the state governmental complex.

The Commission views with much concern the introduction at this time of HR 14138. The bill would impose upon the State of Illinois and its political subdivisions certain regulatory controls and functions which, in the opinion of this Commission, are basically of a local responsibility.

These controls and functions have been in effect in Illinois for more than 30 years with highly satisfactory results due mainly to the work of this Commission.

It is the opinion of the members of the Commission that insofar as the State of Illinois is concerned, H.R. 14138 is unwarranted and unjustifiable for several reasons which will be expanded upon in Mr. Weinberg's statement.

From the amount of information that has been requested of the Retirement Systems by members of your staff during the last two years, we may conclude that this bill will bring about a considerable amount of additional administrative effort and expense for the Public Retirement Systems with the accompanying cost burdens to be imposed entirely upon the taxpaying public.

It is the considered opinion of this Commission after many years of experience in this area of regulation and direction of the Public Retirement Systems, that the problems confronting these plans can most effectively be dealt with at the State and local levels since the systems are maintained as an adjunct of a progressive personnel policy. The problem, therefore, is fundamentally one of individual concern for each governmental unit.

The Commission, therefore, expresses objections to HR 14138 and records its objections thereto restating and reaffirming its previous recommendation on this legislation.

Thank you for the privilege of appearing before your committee.

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STATEMENT OF HON. ROBERT J. EGAN, ILLINOIS STATE SENATOR AND CHAIRMAN, ILLINOIS PUBLIC EMPLOYEES PENSION LAWS COMMISSION, ACCOMPANIED BY A. A. WEINBERG, CONSULTING ACTUARY FOR THE COMMISSION

Mr. EGAN. I have submitted a statement. I don't want to read it. I think for the record I will leave it at that.

Mr. SIMON. Your statement will be entered in the record.

Mr. EGAN. There is one article that I might mention. Mr. Mueller has been quoted in the Pensions and Investment publication, October 23, as saying, "I haven't heard of any opposition so far to the bill." I think that was just the day after we sent a letter to the chairman of the subcommittee expressing our opposition.

Mr. ERLENBORN. You know how the post office is.

Mr. EGAN. In any event, I think you know from the past our opposition and the reason. My only reason for being here is to question the need for the bill in Illinois. If we are doing something wrong, I would like to know how you are going to correct it in Congress when we can't. And I would like to know the answer to that question. If in fact we have to have a Federal law to regulate our systems, the world should know why, and I think the Governor should know why in particular. So that is my question.

Mr. SIMON. Before you got here, I mentioned that I am not nearly as knowledgeable as my colleague from Illinois, Mr. Erlenborn, who, along with Congressman Dent, has led in this area. But I do recall back when I was serving on the committee in the State legislature, we had some State pension systems that were in a pretty shaky state. As you look around the Nation, that situation does exist elsewhere.

I can't help but feel that perhaps 5 or 10 years from now it could once again exist in the State of Illinois.

Let me ask this question of you. Would the Federal statute impose an undue burden on the systems of the State of Illinois, and if so, why? I am aware of your opposition. But I am not aware of the detailed reasons for the opposition.

Mr. EGAN. As briefly as I can put it, let me just explore the facts for a minute. We have the university system, the State system for employees, the judicial system, legislative and a few others, principally about six. Al?

Mr. WEINBERG. Seventeen.

Mr. EGAN. Seventeen. Besides the downstate police and fire systems, which are multiple. We would like to unify those systems. That is another problem. My hope is that we can unify those.

Mr. SIMON. If I may interrupt, as I recall it has been a hope for a long time.

Mr. EGAN. That is right. The big problem we have is funding these systems from general revenue funds. If we were to do this, we would need—I think the unfunded liability for all the systems amounts to almost the total of 1 year's State budget, about $7 or $8 billion.

So if you were to impose on us that requirement, the State would have to borrow the money or raise the income tax. And we all know what a disaster that would be.

Mr. ERLENBORN. Mr. Chairman, might I point out to the witness, if he is not aware of it, that the pending legislation, subject to this hearing, has no funding requirement.

Mr. EGAN. I understand that. But I just want to point out the basic facts. Congressman Simon has expressed his concern over some of these systems being perilously close to bankruptcy.

Mr. ERLENBORN. What this bill would do, of course, is require that there be accounting and actuarial evaluations of these systems and a public disclosure of their condition. Do you object to that?

Mr. EGAN. We do that now. There is no objection to that. The objection is we are going to have to do it again. There is no need to duplicate that which we are already doing.

Mr. ERLENBORN. How often do you do it? Annually?

Mr. EGAN. Yes.

Mr. ERLENBORN. That is what this bill requires.

You have no additional requirement whatsoever.

Mr. SIMON. I guess my question, maybe I am not being clear enough, but how would that disclosure requirement adversely affect Illinois if you are disclosing anyway?

Mr. EGAN. People from the systems are here. They will tell you why that is a burden. All I am suggesting is that if there is a need in Illinois, I would like to hear from the sponsor of the bill why that need exists. I think I know the answer to the question. The State does not contribute its sum, its employer's share. It has not for 40 years. Consequently, we have unfunded liabilities amounting to $7 billion in these systems.

The first thing I did when Governor Thompson was elected, before he took office, was to meet with him at the John Hancock Center and ask him if he would just contribute a little bit more than Governor Walker had done. As a matter of fact, he reduced it below the payout level. His budget contained less money than any Governor that I can remember. Historically, the Governor's budget included money to pay out only that which was necessary to retirees and not the total amount that the employer share should have been budgeted.

Mr. ERLENBORN. Excuse me. But for the record, which Governor reduced it below the payout?

Mr. EGAN. Governor Walker.

Mr. ERLENBORN. That wasn't clear.

Mr. EGAN. At least Governor Thompson brought it back up to the payout level. I asked him to do just a little bit better and for the next 40 years contribute more. He could not do that apparently because he didn't. That is his problem. I think we can and we should. If we do that, 40 years hence the systems will be fully funded.

If they are funded at a 65-percent level, we feel that that is a safe level. There won't be a lot of requests for liberalizing the benefits. If the systems were 100 percent funded, then everybody would want—instead of 300 bills as previously, there would be 600 for liberalizing benefits. So the State area is about 65 percent funded.

That is our only problem in Illinois. There is no problem with the way these systems are run in my opinion.

Mr. ERLENBORN. Can I interrupt there for a moment? Does that comment extend to the local municipal funds as well? Or are you talking only about the State funds?

Mr. EGAN. I am talking about the five principal funds in the State. I understand in local systems there is great variance in how they are handled. It would help to unify the systems.

Mr. ERLENBORN. Is there any State legislation at the present time that establishes fiduciary standards for the trustees of, say, the local fire and police funds, requires annual accounting and actuarial evaluations and requires that information about the systems be given to the participants?

Mr. WEINBERG. Congressman Erlenborn, there is no legislation pending on that issue.

Mr. ERLENBORN. Or on the books?

Mr. WEINBERG. Or on the books. But in Illinois we have a public employee pension fund division of the department of insurance that has authority to make annual audits of these pension funds and check their operations very closely.

Besides, that agency also publishes an annual report in which they set forth the financial conditions of the funds. We do have these regulatory controls in the measure that are contemplated by this H.R. 14138.

Mr. ERLENBORN. Let me comment in answer to your question, Senator. Even if we were to say that your State funds were in rather good shape and you are doing the things that would be required under PERISA, it certainly appears the legislation would be desirable so that the local public pension funds would get the audits that they should and that some fiduciary standards be established for those who are fiduciaries managing those funds.

Besides that, let me say that this bill is not directed to Illinois State funds. So don't take it personally. An awful lot of people in the private sector didn't think ERISA was necessary either and there were abuses. But they were not necessarily all that widespread or completely pervasive.

However, if there is sufficient information to show that there are abuses that can be remedied by encompassing legislation, I think we are then justified to go ahead without exempting those States that may have been doing better than others.

Mr. EGAN. I appreciate your concern. Let me just say I don't think it is necessary in Illinois. I am asking Congress if they intend to pass this bill why it is. That is all my question is addressed to. Why do we need this bill in Illinois? I think that we are doing as adequate a job as can be done. I don't think that the Federal Government is going to do any better.

It is not a matter really of jealousy. But we have attended to these problems and we are serious about them.

Mr. ERLENBORN. Have you taken care of those local fire and police funds? Have you established fiduciary standards?

Mr. EGAN. Which ones are you concerned about?

Mr. ERLENBORN. Let me give you an example. I probably shouldn't mention names. There was one that I established when I was in the practice of law in a very small community that happened to be tax rich. It had a tremendous tax base. I don't know how they stand today. But there is no requirement as I understand it that that or other local fire and police pension funds have annual audits, nor is there a State

law that establishes the fiduciary standards for the administrators of those funds.

Mr. EGAN. Have they abused the trust laws? These systems are certainly subject to the trust laws of the State. Any participant in that fund can take a court action and make sure that if they are making or committing abuses that they be corrected. They are governed. My question is which ones are you complaining about.

Mr. ERLENBORN. Let me recommend if you have not yet read it the report that was approved by this subcommittee relative to public pension plans, I think in March of this year, which will point out that at State and local levels throughout this Nation there are funds that have not even had a financial accounting for 5 or 10 years, that do not give information even on request to participants to let them know what their rights are in the plan.

That doesn't necessarily point a finger at Illinois. But Illinois if we pass Federal legislation will not be exempted. You will have to follow the same standards that the other States do.

Mr. EGAN. The systems will have time to explain their opposition. I just question the need for Federal regulatory intrusion. I think we are doing a good job in Illinois. That is the reason I have come today. I think the fact that you have the bill in Congress points a finger at Illinois and in some measure, in some degree, is critical of what is happening here. I just want to set the record straight. There isn't a State in this Nation that is doing a better job with the public employee pension systems than Illinois. I want to know who they are.

Mr. ERLENBORN. To set your mind at ease I will publicly state that I had New York and Pennsylvania in mind when we introduced the bill, not Illinois.

Mr. EGAN. All right. Thank you.

I would like Mr. Weinberg to conclude. Then you can hear the real objections from the system.

Mr. SIMON. I would still like to hear something solid addressed by the two of you. The question is, is this any kind of a hardship imposed on Illinois if this is enacted?

Mr. WEINBERG. I presume there will be some expense entailed by the application of this law in the case of the public pension funds. As you know, the Federal Government generally requires the preparation of periodic reports which may call for additional burdens to the local areas.

I think generally this will be extended and expanded to the point where it might become burdensome to the local governments.

Mr. EGAN. Congressman Simon, the question is not, does it burden the system? The question is, is it necessary? Why enact a law that is not necessary? My question is, where is the need in Illinois? Maybe New York or Pennsylvania. But I am concerned about Illinois.

Mr. SIMON. I guess my own response to that is that at this point I am not that familiar with abuses in Illinois, if there are any. But there is no question that some of the pension systems around the Nation are weak. There is also this problem of the disclosure problem. That has improved appreciably in Illinois.

I see my friend Roy Baker back there. I think you are still with the downstate teachers pension system. I can remember after Noble

Lee and Al Weinberg gave me the information and I saw what the situation was in the downstate teachers pension system under Roy Baker's predecessors, when I wrote a column and said what the facts were. He obviously did not want that disclosed to the teachers at that point. He is a fine gentleman, would make a fine neighbor. But he felt threatened by the very fact that we were disclosing what the financial situation was. That situation does exist.

Mr. EGAN. That is my question. What situation exists?

Mr. SIMON. I am not saying it exists in Illinois.

Mr. EGAN. I can't help but interrupt, Congressman. I am sorry. But in Illinois we are in my opinion an example. Why this bill exists, we should focus on the need. If there is no need for it then I want to expose the idea to the world that we don't need it in Illinois or we don't see the need in Illinois. Until I can be told why there is a need in Illinois I must oppose the bill.

I am more than appreciative of your effort in this bill, Congressman Erlenborn. As a legislator, I appreciate what you are doing. But we have got to tell the people the need for the bill in Illinois, as far as I am concerned. And if there is no need, we have to tell them that there is no need. My question still is, why do we need the bill?

Mr. ERLENBORN. My answer still is that I will make sure the staff sees that you get one: read our report, March 15.

Mr. EGAN. We have been at this for 2 years. I still don't see a need.

Mr. ERLENBORN. There are plenty of abuses that are revealed in that report.

Mr. EGAN. In Illinois?

Mr. ERLENBORN. In the Nation.

Mr. WEINBERG. In connection with that small police pension fund that you established some years ago in your community, I might point out I made reference a few moments ago to the public employee pension fund division of the department of insurance that makes these examinations and audits.

Through these audits the small funds have been required to provide certain financial reports and as a result they are now compiling these financial records. They have to do it. The division has prescribed the forms that they are to keep.

Mr. ERLENBORN. Are these made public in the community?

Mr. WEINBERG. They are made public by the annual report by the department of insurance, their publication. I assume anyone in the community can get a copy. The funds themselves are given copies so that they can refer to the copies and see what the status is of that particular pension fund.

Mr. ERLENBORN. Are there requirements for vesting, minimum funding standards, portability, fiduciary standards?

Mr. WEINBERG. Not specifically. But implied. The law itself and its provisions——

Mr. EGAN. There are regulations.

Mr. ERLENBORN. Fiduciary you may have some. The State has not yet seen fit to establish general standards as we have in ERISA.

Mr. WEINBERG. These laws do provide——

Mr. ERLENBORN. Funding?

Mr. WEINBERG. Yes, funding.

Mr. ERLENBORN. Do local plans follow that law the way the State does, honoring it in its breach?

Mr. WEINBERG. I would assume through these annual examinations by the Department of Insurance they have to comply.

Mr. ERLENBORN. Does the department have authority to order them to fund if they are underfunded?

Mr. WEINBERG. I think they do have that authority.

Mr. ERLENBORN. I think we ought to research that. I am very worried about many of these small plans as well as the State plans. I recall when Governor Walker was a candidate he campaigned on the proposal that he was going to fully fund the teachers pension. I recall the Illinois Education Association later, after he became Governor and vetoed the funding bill, had to file suit. I think it was in the Court of Claims.

I have always enjoyed telling about how the Republican attorney general, Bill Scott, went in and pled guilty on behalf of the State. I guess ultimately the court decided that there was no way that you could force the State to live up to its obligation to fund. We are not requiring that in this legislation. But the facts ought to be made known.

Mr. SIMON. If I may ask a more general question that does not apply to this legislation, where do we stand on funding on, say, the five major systems? What percentage are they funded now as compared to, say, 3 years ago or 5 years ago or 10 years ago?

Mr. WEINBERG. I might say, Congressman Simon, the rate of funding is gradually improving.

Mr. SIMON. Good.

Mr. WEINBERG. It is improving. The ratio of assets to liabilities——

Mr. SIMON. Like the Downstate Teachers Pension System.

What is it funded at today, at what level roughly?

Mr. WEINBERG. It is in the forties, about 44 percent.

Mr. SIMON. I remember at one point it was about 28 percent or less than that.

Mr. BAKER. About 5½ years ago we were 29 percent funded. The last annual report, which was July of 1977, a little over 46 percent funded. So we have made some strides.

Mr. WEINBERG. It is above 40 now.

Mr. ERLENBORN. How is the legislative system?

Mr. WEINBERG. It is about 52 percent.

Mr. EGAN. Legislators are in better shape than anybody except maybe the judiciary. That is because they work hard and they don't retire.

I think if you hear from the individual systems you will find out their particular objections. I appreciate very much the opportunity to express on behalf of the commission, one of the hardest working commissions in the legislature.

Mr. ERLENBORN. Could I ask the senator to do one thing if you would? On behalf of the subcommittee I would ask you if you would submit for the record a statement showing for the State systems under your jurisdiction where you are meeting the requirements of PERISA currently and where you are not so that we will have an idea of additional burdens.

Mr. EGAN. We have an annual report that is quite thorough. You can have that. And I will be more specific about your question. I will submit a statement.

Mr. SIMON. If you would also have the names of the members of the Pension Laws Commission and send a copy of the report. I think if you take a look at what is happening in some of the other States that you might have a little more sympathy.

Mr. EGAN. I talked with Mr. Mueller in Washington. I am familiar with that but not enough. I am in sympathy with your objective. I just want to make the record clear that in Illinois we don't need it in my opinion. So thank you.

Mr. SIMON. We thank you. Good to see you again, Senator. I recall the position of chairman of the Pension Laws Commission was not a much-sought-after position. I commend you for taking it on.

Mr. Weinberg, you have been a gem in the whole field. Great to see you again.

Mr. WEINBERG. Thank you. Nice to see you.

I might mention in my paper that I believe you have a copy of I deal with some of the questions as to this discussion.

Mr. SIMON. We will enter your paper in the record.

Mr. WEINBERG. Yes.

Mr. SIMON. Thank you very much.

[The prepared statement submitted by Mr. Weinberg follows:]

PREPARED STATEMENT BY A. A. WEINBERG, CONSULTING ACTUARY, FOR THE COMMISSION

We have studied the provisions of this measure. The bill is far-reaching in its objectives and its implications. It seeks to impose certain functions in the federal government which are basically of local character and concern. It will give rise to many procedural and legal questions.

In the opinion of the Commission, the bill is decidedly objectionable because it represents an unwarranted and unnecessary intrusion into the area of State and local authority and responsibility. The effect of this bill would be to relinquish State's rights to the federal government. The Commission is fearful that the enactment of a measure of this kind and the establishment of the concept that it embodies would ultimately lead to further erosion of State's rights and local authority and the extension of federal influence into matters that are exclusively of local concern and local policy determination.

Administration.—The bill would bring about the enactment of the "Public Employees Retirement Income Security Act of 1978" commonly referred to as "PERISA". The "Employee Benefit Administration" created by the Employee Retirement Income Security Act of 1974, referred to as the "Administration" would direct and administer the agency created by this bill. The functions of the "Administration" would be to formulate and prescribe standards of conduct and responsibility and obligations for fiduciaries of State, local and federal pension plans. It would prescribe remedies and civil sanctions for lack of compliance with recommended standards and regulations.

The "Administration" would be monitored by an "Advisory Council on Governmental Plans" consisting of 11 members appointed by the President. The Council would make recommendations to the administration with respect to the regulations to be issued and to otherwise properly discharge its duties and responsibilities under the Act. The Council would also establish voluntary guidelines on related subjects not specifically covered by the Act such as funding or vesting for the information of the Administration.

Reporting, disclosure and fiduciary standards.—The agency to be established by this bill would require the filing by the public pension plans of periodic reports on reporting, disclosure and fiduciary standards. Regulations and rules defining these standards would be promulgated by the Administration. Amendments to the Internal Revenue Code would be proposed, presumably by the Ad-

ministration, to formally declare that public pension plans have a qualified status under the said Code with an exemption of these plans from taxation.

This part of the bill dealing with reporting and disclosure and the emphasis on the fiduciary responsibilities of plan trustees has little relevance to the public pension plans in Illinois. In addition to the "Illinois Public Employees Pension Laws Commission" which has been a part of the State government complex for more than 30 years, we have in our State a "Public Pension Fund Division" of the State Department of Insurance. This division, in essence, is a regulatory agency with respect to reporting, disclosure, and fiduciary standards and policies. It has authority to audit and examine the pension plans at any time and inquire into the results of their operations and management activities. This division requires the filing of annual reports by the pension plans, in a detailed and comprehensive form, similar in scope and content to the form of report filed by insurance companies.

Existing controls.—The aforesaid procedures and requirements may be considered as constituting regulatory controls in the State of Illinois concerning the operations of the pension plans. It is understood that during recent years similar measures to regulate the management and administration of public pension plans are being instituted in other States. Incidentally the Public Employee Pension Fund Division of the Department of Insurance referred to above was created some years ago upon recommendation of the Pension Laws Commission.

Another form of control or regulation exists in Illinois which is proving of increasing practical value. I have reference to the Illinois State Board of Investment created also upon the recommendation of the Pension Laws Commission. This unit is intended to provide expert investment management for the reserves being accumulated by the several pension plans, thus giving these plans the advantages and benefits of a joint effort in this highly important management function and responsibility.

Small membership units.—There is one important area in pension plan operations in Illinois that requires resolution. It is a problem that is common to all other States in varying degrees. We have reference to the small membership units. The maintenance of a sizable number of small membership units under two statewide pension statutes, for policemen and firemen, is certainly indefensible from the standpoint of a constructive pension policy. It is a situation, however, that can only be resolved by local initiative, and not by action of the federal government.

Funding.—In the area of funding which is a subject facing all public plans including those maintained by the federal government, increased appropriations by the State in the case of the state-funded plans, and upward adjustments in existing tax levies, is the only way such a situation may be alleviated. Certainly the federal government is not going to authorize special grants to these plans for the purpose of bringing about improved funding.

Over the years the Pension Laws Commission has consistently recommended the current budgeting concept for providing the employer's share of the accruing pension liability since such cost is basically an integral part of the current salary expense. This, in the opinion of the Commission, is a realistic approach to an important basic problem in the funding of the public plans. Sound financing requires that the employer's cost be budgeted and paid over concurrently with the payment of salaries. This method brings into focus the cost accounting concept and is referred to as "current budgeting".

Conclusion.—It is understood that certain constitutional questions of enforcement arise in the case of State or local governments which render enforcement remedies for public plans somewhat questionable. These matters may be cited in opposition to any federal regulation of reporting, disclosure and fiduciary standards.

It is the considered judgment of the Commission, after a review of all aspects of this problem that any attempt to regulate standards of conduct or procedure in the operation of public plans, will give rise to many legal and policy questions that will be difficult of resolution. It is our view that the most practical way to insure proper management and administration of the local plans and the maintenance of adequate and effective reporting and disclosure standards, is through appropriate State agencies, as in the case of the State of Ilinois.

Creating a new division of government at the federal level to deal with these local matters, cloaked with auditing and investigative authority, and directed by an "administration" and an "advisory council" as proposed by H.R. 14138, is un-

necessary and unwarranted, as we have stated. In our opinion such action would constitute an infringement of State and local authority and responsibility. Such an arrangement would also give rise to serious constitutional questions and operating problems rendering administration and enforcement difficult of accomplishment.

We are therefore impelled to strongly recommend the disapproval of this bill.

Mr. SIMON. Mr. Henry Bayer, director of AFSCME, Council 101.

If you would identify those with you, Mr. Bayer, we would appreciate it.

[The prepared statement of Mr. Bayer follows:]

STATEMENT OF HENRY BAYER, EXECUTIVE DIRECTOR OF DISTRICT COUNCIL 101, AFSCME, AFL–CIO

I am Henry Bayer, Executive Director of District Council 101 of the American Federation of State, County and Municipal Employees, AFL-CIO. With me today are Michael Leibig, of the Washington, D.C. and Detroit, Michigan law firm of Zwerdling and Maurer, and Robert Kalman, Assistant Director of Public Policy for AFSCME International. Bob and Mike have just completed a book on the reform of public pensions which will be published by Hopkinson and Blake Press later this year.

District Council 101 is based in the Chicago area and represents over 10,000 state, local and college employees. AFSCME represents over 50,000 public employees in Illinois, has over one million members nationally, and is the largest union in the AFL–CIO. As the primary representative of non-teaching public employees in the nation. AFSCME is vitally interested in the soundness, security and reform of public pension systems.

As a number of other witnesses in these hearings demonstrate, the problems of public pensions are becoming an increasingly important issue.

There are a great number of issues in the public pension area which the Subcommittee will be addressing in the next session of Congress. I would like today, however, to concentrate on three of them—funding, fiduciary responsibility and reporting and disclosure.

The Report of the Pension Task Force, prepared under the direction of this Committee, is particularly helpful here. Appendix VII of that report is a detailed review of the State and Local Pension Plans for the State of Illinois prepared by the American Law Division of the Library of Congress.

Illinois has over 450 state and local pension plans. All but two of these plans are covered by the Illinois Pension Code. The Library of Congress Report contains a summary and analysis of these plans on the points of coverage, funding, financing, and fiduciary standards, as well as an in-depth examination of them on the same basis. A first reading of the report creates the appearance of a complicated but sophisticated modern system of pension protection for the public employees of Illinois. But what does a more careful review show?

Begin with the fact that the Illinois Department of Insurance reports a total unfunded liability of $7 billion dollars for these funds. And yet, the Library of Congress report describes systems which would seem to have adequate safeguards and guarantees in the funding area. What could these mean? The problem is that there exists no remedy in Illinois for persons injured by failure of the existing plans to meet their funding obligations or by failure of trustees of these plans to fulfill their duty to manage the plans in the interest of participants and beneficiaries. At the same time, inadequate reporting and disclosure both with regard to plan, operation and the financial management of the plans leaves participants and beneficiaries without access to understandable, meaningful or usable information.

Let us look at each area separately for a moment:

FUNDING AND FINANCING

The Library of Congress defines funding as "the required contributions of both employees and the government." It defines financing as "the resources behind the promised government contribution." The key question for the Subcommittee is what happens when a gap opens between funding and financing? When a plan fails to meet the funding promises which have been imposed at the local level,

what happens? When a participant or beneficiary making contributions to a plan finds that the government has not been meeting its obligation, what recourse does he have?

The Constitution of the State of Illinois provides that:

"Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired. Article XII, Section 5."

The Library of Congress reports, however, that "the applicability of this provision to the financing of pension benefits is not totally clear." In fact, it is currently impossible in Illinois to insure that a government making a promise to fund a pension commitment at a given level will keep that promise. The Constitutional Commentary to the Illinois Annotated Statutes, for instance, states that the constitutional provision "does not require the funding of pension programs." In fact, the $7 billion in unfunded liabilities stands in testament to the impossibility of enforcing state pension commitments.

The Courts in Illinois have consistently refused to require that these promises be kept. See, for example, the *Illinois State Employees* v. *McCarter*, *People, ex rel IFT* v. *Lindberg*, and *Illinois Education Association* v. *Illinois* cases, and a 1977 article on public pensions in Volume 90 of the Harvard Law Review at p. 992.

FIDUCIARY STANDARDS

The Library of Congress' most forceful statement on the duties of the trustees of Illinois public pension systems is that "The general duties of trustees would appear to apply to these trustees in the absence of special provisions."

It is generally believed, and may be generally accurate, that public pension plans must be managed for the benefit of participants and beneficiaries according to the same fiduciary standards that control private pension funds. As a technical, legal point, this may be more difficult to establish than at first appears. Efforts to enforce traditional fiduciary obligations against decision makers and trust managers must overcome sovereign immunity and separation of power defenses. It must then be established that the plan is indeed a trust, designed to be managed for the exclusive and sole interest of participants and beneficiaries.

Depending on the statute involved, this may be relatively easy or very complicated to prove. There may be no specific "fund" involved in the plan. It may be far from apparent that public pension participants and beneficiaries have equitable title in a public pension fund. Furthermore, no explicit declaration of trust with respect to the fund's assets may exist. It may also be difficult to establish clearly that plan assets are, in fact, a separate trust fund, rather than a simple division of the budget or accounts of the governmental employer involved.

Even if it is established that a trust fund does exist and that fiduciary duties do apply, the specific duties of plan fiduciaries may remain in question. Public fund fiduciary duties may vary considerably from those of private trust fund fiduciaries. Statutory provisions may exist, allowing any investment gains to be returned to the general fund of the government. Trustees may not be obligated to consider investment return against risk.

A statute may also impose requirements to invest in governmental securities, securities of businesses within the jurisdiction, or limiting investments in other ways. Other statutory requirements may change traditional rules of diversification of trust assets. Traditional rules of prudence may be relaxed somewhat during situations of grave financial crisis.

In *Withers, et al* v. *Teachers Retirement System of the City of New York, et al.*, a federal district court in New York recently found that public pension fund trustees did not breach fiduciary duties by investing in employer bonds, when the public employer sponsoring the plan was thought to be on the brink of bankruptcy. The court concluded:

"[that the trustees' initial] hesitation as to the quality of the bonds and the undesirability of committing so large a proportion of the fund's assets to a single class of security was outweighed by what they conceive as their paramount obligation to insure the survival of the fund."

This is contrary to the general rule applied to private pension trusts in *Blankenship* v. *Boyle*, which held that pension trustees should not consider the interest of employees and pension participants in maintaining the economic strength of the employer when making pension investments.

REPORTING AND DISCLOSURE

The problems of funding and fiduciary abuse might be mitigated to some degree if the argument could be made that everyone involved is aware of the situation and knows that the promise to pay a pension is conditional, that promises to fund are less than fully reliable, and that the duties of fiduciaries to manage funds in the interest of their beneficial owners are less than they would be in the private sector. This argument cannot be made; however, where strict independently enforced reporting and disclosure requirements do not exist or where they are not enforced.

CONCLUSION

There is a clear need for reform of the public pension systems of the State of Illinois. Reporting and disclosure, fiduciary duties, and remedies for those injured by broken pension promises are the areas where such reform should begin.

We are prepared to answer questions on these or other points.

[From Pension World, August 1978]

How Much Federal Regulation Do Public Funds Need?

(By Michael T. Leibig and Robert W. Kalman)

The unregulated control by plan managers and the private financial community over the $110 billion in public pension fund assets and the lack of adequate public pension plan reporting and disclosure demand urgent reform.[1] Conflicts of interest and inadequate reporting and disclosure, unfortunately, are the rule among the more than 6,000 state and local pension plans.

Claims to the contrary are extremely misleading. In a recent editorial in a prominent pension journal, for example, Carmen Elio, Director of the Massachusetts Retirement Law Commission, claimed that "tremendous progress" has been made in the area. He suggests that the remaining problems will best be solved by the "velvet glove" of the private financial community, rather than the "sledgehammer" of federal legislation.[2] Such claims are refuted by the facts.

CONFLICTS OF INTEREST

In a widely cited study of the asset management practices of state and local pension funds, Louis Kohlmeier documents the widespread nature of conflicts of interest that exist in public employee pension plans.[3]

Kohlmeier demonstrated that to a "considerable degree [public pension funds] are controlled by city and state employers." He has shown that of the $93.5 billion (1974 value of assets) held by public pension funds, much is managed in the interests of those who control the funds rather than in the interests of those whom the funds are intended to benefit.[4]

ESTABLISHING STATUTES

Statutes which establish state and local pension funds usually create a board of pension fund trustees. Most often, the trustees are appointed by an elected official; typically they are charged both with fund administration and investment management. "Most frequently, the boards are composed largely or exclusively of public officials, lawyer representatives, and others who are not professionally trained to invest large sums of money." [5] Typically, professionals are not on the board of trustees. Money managers, usually banks, are used.[6]

How do these pension trustees rate as "managers"? The Congressional Pension Task Force found that the standards which plan officials must meet in their conduct are vague. The Task Force observed in its 1976 *Interim Report* that:

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[1] Bureau of the Census, U.S. Department of Commerce, *Financial of Selected Public Employee Retirement Systems*, Quarterly Report, December 1977.

[2] Carmen Elio, "Public Reporting and Disclosure," Guest Editorial, *Pension World*, December 1977, p. 3.

[3] Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management* (New York Twentieth Century Fund, 1976).

[4] *Ibid.*, p. 11.

[5] *Ibid.*, p. 9.

[6] See Note, "Public Employee Pensions in Times of Fiscal Distress," 90 *Harv. L. Rev.* 992 (1977) pp. 1013 through 1116 on the selection of trustees and the relative merits of governmental officials, union representatives and "neutrals" on boards of trustees.

. . . public plans in general do not appear to be operated within the general financial and accounting parameters established by custom and practice [and now by ERISA] in the private pension retirement plan field. *The absence of any external independent review has perpetuated a level of employer control and attendant potential for abuse unknown in the private sector.* [Emphasis supplied.][7]

In 1977, Greenwich Research Associates carefully reviewed over 150 of the largest public sector funds and found major problems in their management. The report concluded:

Forty-eight percent of the public pension funds report they have problems with their investment manager, and some of the problems they have with their own managers are those they would consider most harmful: portfolio managers don't give each account the individual attention it deserves: managers don't keep clients properly informed between meetings; investment review meetings and written material are too superficial; and portfolio managers are changed too often.[8]

Kohlmeier has pointed out that the most fundamental question in this area is, whose interests come first: the pension beneficiaries, the employers, or the investment managers?

[The] possibilities for conflicts are numerous. For example, some trustees and their staffs decide how the brokerage commissions generated by the fund's portfolio transactions will be allocated; and when they make these decisions, it appears that the commission business is often channeled to favored regional broker-dealers with political influence or friends in the state or city government. But when investment advisors decide where portfolio securities will be bought and sold, other conflict questions arise—for example, when the investment advisor is a bank having commercial relationships with broker-dealers to whom it allocates brokerage business. Almost all public pension funds appear to allow their investment advisors to obtain research from broker-dealers through "soft dollar" payments—that is, in exchange for commission business. But few if any pension funds have established controls to ensure that safe dollar benefits obtained by investment advisors accrue to the benefit of the pension funds paying the transaction costs rather than the benefit of the advisors' other customers . . .

[*If*] *pension fund trustees and staffs fail to equip themselves with more sophisticated money management techniques and with more effective surveillance of their hired money managers, conflict-of-interest problems—and abuses—will also* continue to proliferate. [Emphasis supplied][9]

Boards of pension trustees have too often ignored funding and investment requirements. Kohlmeier describes abusive situations in Illinois, Maryland, New Jersey, Philadelphia, Los Angeles, Virginia, Maine, Nevada, Georgia, North Carolina and other areas.

It is clear that the "velvet glove" of the private sector financial community too often hides a grasping hand and that the frequent tie between banks or private financial managers and public funds endangers the funds' position. Investment decisions are motivated by the investment needs of those controlling public pension funds, rather than the security needs of the consumers of public pensions—plan participants and beneficiaries.

Too often, public funds, on the advice of the private financial community, invest a disproportionate share of their assets in local mortgages or unwisely concentrate investments in other ways. Largely inexperienced public pension fund administrators, especially those of smaller funds, must rely on such advice, intensifying these problems.[10]

REPORTING AND DISCLOSURE

Equally as important as conflict of interest problems is the degree to which secrecy and lack of public disclosure dominate the public pension area.[11] In fact, Kohlmmeier found that conflicts of interest problems:

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[7] Pension Task Force, Subcommittee on Labor Standards, Committee on Education and Labor, U.S. House of Representatives, 94th Congress, Second Session, *Interim Report of Activities* (Washington, D.C.: U.S. Government Printing Office, 1976), p. v.

[8] *Public Pension Fund Trustees Reports* (Greenwich Research Associates, 1977), p. 17.

[9] Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management*, pp. 9 and 10; See also A. H. Raskin, "Pension Trustees Juggling Inherent Interest Conflicts." *The New York Times*, March 16, 1977.

[10] *Ibid.*, pp. 11–26, As one part of the Congressional public pension study mandated by ERISA, the Senate participants in the Joint Pension Task Force have requested that the General Accounting Office make a study of pension asset management practices in six states, following the Kohlmeier format. The results of this study, however, are not yet available.

[11] See Robert Blixt, *Pension World*, December 1976, pp. 3–4.

* * * are compounded by the general failure of public pension funds to make full public disclosure of how investment authority is divided and the methods by which depository banks, investment advisors, and broker-dealers are selected . . . Control and surveillance can minimize the effects of conflicts. And in itself, greater disclosure should help prevent the unavoidable conflicts from growing into situations that are harmful to both pension fund beneficiaries and the general public, which must ultimately pay the bills.[12]

The preliminary results of the Congressional Task Force study of public pension plans show that:

Almost *half* of the 800 plans surveyed do not regularly distribute plan description booklets to participants, including more than 25 percent of plans with more than 1,000 participants.

60 to 70 percent of all state and local systems do not disclose (or know) the market value of plan assets; of those that do, about 40 percent show a market value of less than 90 percent of book value.

25 percent of all state and local plans have *never* had an actuarial valuation and about *one-third* have not had one within the last five years.

Nearly one-third of large state and local plans are never audited by a certified public accountant.

Public retirement sytsems suffer from other serious deficiencies in disclosing plan information to participants and beneficiaries.

Because of the absence of disclosure, plan participants and beneficiaries seldom know their pension entitlements, let alone how to object to the practices involving the management of plan assets.[13]

Kohlmeier's study reinforced these conclusions. He found that:

Most public pension funds make financial reports of some kind to the legislature, to the governor or mayor, to employees and/or to the general public. The great majority of such disclosures are wholly inadequate to allow legislators, employees or the public to judge the adequacy of fund administration . . . Rarely do reports disclose individual [investment information capable of being analyzed].[14]

Few, if any, public pension systems provide for regular, meaningful reporting and disclosure. Often the data necessary for such disclosure are unavailable, even to the asset managers. Detailed investment studies are rare; actuarial reports, on a regularly updated basis, are neglected.

The problem with secrecy concerning basic information of public pension systems is not limited to backward, small or outmoded plans. Confidentiality and the privacy rights of plan participants are, at times, relied upon to prevent reporting and disclosure of even general or aggregate information about a plan's finances, its actuarial health, or the cost of plan amendments. This is so even when the request for such information comes directly from plan participants or their representatives.

For example, the problem of limited disclosure infects even "reforms." In April 1977, the Department of Labor announced a $200,000 contract with the Massachusetts Retirement Law Commission to establish a New England Retirement Law Council to do a study of public pension systems within the six New England states. The eighteen month study aims at coordinating a network of pension plans and establishing a computer data bank. The Department of Labor has announced that the New England Council "will create a complete data base on the characteristics, funding status, and coverage of all public pension systems within the boundaries of the six New England states." It is planned that the computer program developed will, among other things, be equipped to calculate the cost of any proposed change in a public pension system in New England.

There is no question that such a system established with federal funds, and on the basis of expert actuarial service, is a real public pension reform. As things

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[12] Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management*, pp. 9 and 10.

[13] See Russell Mueller, Actuary for the Congressional Pension Task Force, "Public Pensions," address before the American Council of Life Insurance, November 1, 1977; Howard Kline, Counsel to the House Pension Task Force, address to National Conference on Public Employee Retirement Systems, March 28, 1977; and "Public Pension Reform," *Pensions and Investments*, June 6, 1977, p. 11.

[14] Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management*, p. 54.

currently look, however, even this new developing reform system has a fatal problem. The information developed by the Commission is to be in the complete control of the executive and legislative departments of the jurisdictions involved. While an initial report will go to the Department of Labor, access to the use of the data bank will be severely restricted. Labor unions, taxpayer representatives, participant and beneficiary representatives, and independent researchers are not currently anticipated to have access to the data bank. This will be the case even when these outside groups offer to pay the cost of a specific answer to a general question such as the cost of integrating a system with Social Security.

The program's Advisory Committee chaired by Alicia Munnell has discussed the problem and the importance of full reporting and disclosure with Director Carmen Elio. Furthermore, the initial unsolicited proposal to the Department of Labor described the program as providing the basis for full reporting and disclosure. However, unless something is changed before the eighteen month study is completed, only those now controlling access to the information about the systems involved will have access to the new computer program.[13a]

LEGAL REMEDIES

It would be misleading to leave the impression that there are no legal remedies for fiduciary abuse of public pension plans. This would imply that no recourse exists to plan participants faced with lack of disclosure or secrecy.

For the most part, private remedies are technically available. Common law and, often, statutory fiduciary protections frequently do exist. State freedom of information and consumer protection systems are available.

REMEDIES CUMBERSOME

These remedies, however, are cumbersome and expensive. They are not designed to provide specific remedies to pension participant or beneficiary problems. Fiduciary duty litigation against the state systems face difficult separation of power and sovereign immunity problems. For the most part, these problems cannot be overcome without sophisticated, expensive legal skills.

Three particular problems without easy solution are: (A) application of traditional fiduciary standards and "prudent man" rules in the public sector; (B) refusal of the government to fund a plan as required; and (C) investment of public pension funds in governmental securities.

FIDUCIARY PROBLEM

It is generally believed, and may be generally accurate, that public pension plans must be managed for the benefit of participants and beneficiaries according to the same fiduciary standards that control private pension funds. As a technical, legal point, this may be more difficult to establish than at first appears. Efforts to enforce traditional fiduciary obligations against decisionmakers and trust managers must overcome sovereign immunity and separation of power defenses. It must then be established that the plan is indeed a trust, designed to be managed for the exclusive and sole interest of participants and beneficiaries.

DIFFICULTIES IN ESTABLISHING

Depending on the statute involved, this may be relatively easy or very complicated to prove. There may be no specific "fund" involved in the plan. It may be far from apparent that public pension participants and beneficiaries have equitable title in a public pension fund. Furthermore, no explicit declaration of trust with respect to the fund's assets may exist. It may also be difficult to establish clearly that plan assets are, in fact, a separate trust fund rather than a simple division of the budget or accounts of the governmental employer involved.

Even if it is established that a trust fund does exist and that fiduciary duties do apply, the specific duties of plan fiduciaries may remain in question. Public

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[13a] See "New England Pension System Study Contract Awarded," *BNA Pension Reporter*, May 23, 1978, p. A–8; see also correspondence between Leibig and Kalman and the Department of Labor, May 11, 1977, May 18, 1977, and June 8, 1977; see also New England Retirement Law Council letter to Kalman, July 12, 1977.

fund fiduciary duties may vary considerably from those of private trust fund fiduciaries. Statutory provisions may exist, providing that any investment gains must be returned to the general fund of the government. Trustees may not be obligated to consider investment return against risk.[15]

A statute may also impose requirements to invest in governmental securities or securities of businesses within the jurisdiction. Other statutory requirements may change traditional rules of diversification of trust assets. Traditional prudent man rules may be relaxed somewhat during situations of grave financial crisis.[16]

In *Withers, et al.* v. *Teachers Retirement System of the City of New York, et al.*, 76 Civ. 4474 (WCC) (S.D.N.Y., 1978) a federal District Court in New York recently found that public fund trustees did not breach fiduciary duties by investing in employer bonds when the employer was thought to be on the brink of bankruptcy. The court concluded—

"[that the trustees' initial] hesitation as to the quality of the bonds and the undesirability of committing so large a proportion of the fund's assets to a single class of security was outweighed by what they conceived as their paramount obligation to insure the survival of the fund." This is contrary to the general rule applied to private pension trusts in *Blankenship* v. *Boyle*, 329 F. Supp. 1089 (D.D.C., 1971) which held that pension trustees should not consider the interest of employees and pension participants in maintaining the economic strength of the employer when making pension investments.

ENFORCEMENT

On a number of occasions, governmental employers have failed to fund their plans in line with the statutory requirements:

Courts have uniformly held these missed appropriations to be contract violations. Depending on their view of the applicable doctrines of separation of powers and sovereign immunity, the states' courts have adopted various responses to requests that they order the state legislator or state executive actually to make the appropriations [needed to fund the plan].[17]

In *Dombrowski v. The City of Philadelphia*, for example, the court ordered the City to put its pension plan on an actuarially sound basis.[18] In Illinois, a court agreed that failure to fund a public plan is illegal. However a separation of power argument convinced the court that no such order was permissable. Therefore, only a declaratory judgment resulted.[19]

INVESTMENT

Some statutes require public pension plans to invest a certain portion of their assets in governmental securities. The pros and cons of such requirements have been developed in detail by the *Harvard Law Review*. Under the Harvard analysis, trustees making the investment might properly look beyond the direct security interests of active plan participants and beneficiaries. They also might consider their own interest in the stability of the government sponsoring the pension plan; the security interests of active plan participants, exclusive of the interests of beneficiaries; and the general interests of beneficiaries and participants in avoiding governmental bankruptcy.[20]

Investments of this type should be considered highly suspect. They should be opposed unless made after all ramifications of these investments are fully and carefully considered.

In the recent New York fiscal crisis, very careful consideration of all elements of the decision was made prior to City pension fund investment in New York securities. Special legislative approval and adjustments of fiduciary re-

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[15] Report of the New York State Permanent Commission on Public Employee Pension and Retirement Systems. *Financing the Public Pension Systems, Part I: Actuarial Assumptions and Funding Policies*, March 1975, pp. 34–35.

[16] See also 90 *Harv. L. Rev.* 992 (1977).

[17] 90 *Harv. L. Rev.* 992 (1977), p. 1006.

[18] 254 A. 2d 228 (1968).

[19] *Illinois Education Association v. Illinois*, No. 6891 (Ct. Cl. June 25, 1973); see also *Weaver v. Evans*, 495 P. 2d 639 (1972) (*en banc.*)

[20] 90 *Harv. L. Rev.* 992 (1977).

quirements were granted; special and specific Federal policy and tax decisions were made which protected the funds.[21]

CONCLUSION

Conflicts of interest in the management of public pension plans and their assets present a major challenge for reform. At the heart of the problem is the disinterest and lack of understanding by public plan managers, participants and beneficiaries, their representatives, and the taxpaying public.

Consumers of public pensions have no active enforcement advocate. No one can control or effectively challenge self-dealing and poor management. There is no agency with adequate authority to demand full, meaningful, and understandable reporting and disclosure comparable to the ones that oversee private plans.

Technical, legal avenues adequate to secure complete information about public pension plans are expensive and complicated. Meaningful access to private legal remedies to these problems does not exist. The disinterest of the past generated present problems. Pension plan participants and beneficiaries and the taxpaying public deserve better.

PUBLIC REPORTING

This is the real world of public sector reporting and disclosure and asset management. Public pension reform is needed in this area. The argument for reform is stronger than the private sector argument which resulted in ERISA. Abuses are widespread; employer and private financial community control is disturbing; plan participant and taxpayer knowledge is kept to a minimum. Views to the contrary, citing "tremendous progress" through the "velvet glove" of the private financial community do not match the facts. They represent a myopic perception of the disturbing reality of reporting, disclosure, and conflicts of interest in the public sector today.

[From Pension World, April 1978]

PUBLIC REPORTING AND DISCLOSURE: ANOTHER VIEW

(By Robert W. Kalman and Michael T. Leibig)

The complete control that plan sponsors and the private financial community exert over reporting and disclosure of public pension plans and their $110 billion in assets demands the most urgent reform. Conflicts of interest and lack of adequate disclosure to plan participants and the taxpaying public, unfortunately, are the rule rather than the exception among the 6,000 plus state and local pension plans.

Claims to the contrary, including Carmen Elio's December 1977 Pension World guest editorial, "Public Reporting and Disclosure," are misleading. Mr. Elio's statement that "tremendous progress" has been made in this area and that the remaining problems will best be solved by the "velvet glove" of the private financial community, rather than the "sledgehammer" of federal legislation is not supported by the facts.

Louis M. Kohlmeier, in his widely-respected Twentieth Century Fund study—"Conflicts of Interest: State and Local Pension Fund Asset Management"—documents the disturbing conflicts of interest, secrecy, and lack of public disclosure that dominate the public pension scene. Mr. Kohlmeier demonstrates that the "velvet glove" of the private sector financial community too often hides a grasping hand and that the frequent tie between banks or private financial managers and public pension funds endangers the funds' position. Investment decisions are motivated by the investment needs of those controlling public pension funds,

[21] See American Bar Association, *1976 Labor Relations Law Committee Reports*, (1976), pp. 416 and 417; Agreement between Municipal Assistance Corporation, N.Y. Banks and the City of New York, November 26, 1975; New York State Statute on indemnification and fiduciary obligations, 1975, N.Y. Laws, Chap. 890; New York Seasonal Financing Act and its legislative history, P.L. 94–143 (Dec. 9, 1975); special amendment to Internal Revenue Code Section 401(a) and its legislative history, P.L. 94–236 (March 19, 1976); 90 *Harv. L. Rev.* 994 (1977) pp. 1005–1016; Michael S. Gordon, "The Politics and Perils of Reforming Public Employee Pension Plans," *Employee Benefits Journal*, Fall 1976, pp. 5 and 6; *Withers, et al. v. Teachers Retirement System of the City of New York, et al.*, 76 Civ. 4474 (WCC) (S.D.N.Y.); and International Foundation of Employee Benefit Plans, "Public Fund Trustees Did Not Breach Fiduciary Duty in Investing in New York City Bonds." *Legal-Legislative Reporter, News Bulletin*, (June 1978), pp. 6 and 7.

rather than the security needs of fund participants and beneficiaries. Often, public funds, on the advice of the "private sector financial community," invest a disproportionate share of their assets in local mortgages or unwisely concentrate investments in other ways. Largely inexperienced public pension fund administrators, especially those of small funds, must rely on such advice, further intensifying these problems. As Mr. Kohlmeier writes,

"Most public pension funds make financial reports of some kind to the legislature, to the governor or mayor, to employees, and/or to the general public. The great majority of such disclosures are wholly inadequate to allow legislators, employees, or the public to judge the adequacy of fund administration. . . . Rarely do reports disclose [investment information capable of being analyzed]." (p. 54)

Similar deficiencies have been uncovered by the House Labor Standards Subcommittee's Pension Task Force. Preliminary findings of the Task Force's comprehensive survey of public plans reveal some very disturbing realities about public reporting and disclosure. For example, it has discovered that 60 to 70 percent of all state and local plans do not disclose (or know) the market value of plan assets. Twenty-five percent of all state and local plans have never had an actuarial valuation and about one-third have not had one within the last five years. Furthermore, one-third of large state and local plans are not audited annually and about 4.5 percent of all plans are never audited.

These and other findings further reinforce the conclusions drawn by the Task Force in its 1976 Interim Report. The Task Force observed in the Report's discussion of public reporting and disclosure that,

"* * * public plans in general do not appear to be operated within the general financial and accounting parameters established by custom and practice in the private retirement field. The absence of any external independent review has perpetuated a level of employer control and attendant potential for abuse unknown in the private sector." (p. v)

This is the real world of public reporting and disclosure, an area that is in urgent need of federal attention. Abuses are widespread; employer and private financial community control is disturbing; plan participant and taxpayer knowledge is kept to a minimum. Views to the contrary, citing "tremendous progress" through the "velvet glove" of the private financial community, do not match the facts. They represent a myopic perception of the disturbing reality of reporting and disclosure in the public sector today.

MEMORANDUM OF OPINION OF THE U.S. DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA IN STATE OF CALIFORNIA V. BLUMENTHAL

NO. CIV. S-78-356-TJM OCTOBER 3, 1978

THE STATE OF CALIFORNIA, BY AND THROUGH EVELLE J. YOUNGER, ATTORNEY GENERAL OF THE STATE OF CALIFORNIA, PLAINTIFF

v.

THE HONORABLE W. MICHAEL BLUMENTHAL, SECRETARY OF THE TREASURY OF THE UNITED STATES, DEFENDANT

Appearances:
William J. Power, Deputy Attorney General, State of California, 555 Capitol Mall, Suite 350, Sacramento, California 95814, Attorney for Plaintiff.
Richard A. Scully, Tax Division, U.S. Department of Justice, Washington, D.C. 20530, Attorney for Defendant.

SCHWARZER, U.S. District Judge

Plaintiff filed this action on July 10, 1978, seeking broad declaratory and injunctive relief against the application of the Employee Retirement Income Security Act of 1974 ("ERISA"), 88 Stat. 829, 29 U.S.C. § 1001 *et seq.*, to pension and retirement plans maintained by the State of California or any of its agencies. Plaintiff asserts that Congress did not intend the Act to apply to governmental plans, and that even if Congress intended otherwise, its application to such plans would violate the tenth amendment. ERISA requires, among other things, the filing of an annual information return by every employer maintaining a pension plan described in part I of subchapter D of chapter 1 of the Internal Revenue

Code, 26 U.S.C. § 401 *et seq.*[1] An unexcused failure to file may result in penalties of $10 for each day during which the failure continues up to a maximum of $5,000. 26 U.S.C. § 6652(f).

Plaintiff has moved for a preliminary injunction to prevent defendant "from imposing . . . or threatening to impose a fine upon plaintiff . . . for plaintiff's refusal to file with defendant the return mentioned in Section 6058 . . ." Defendant takes the position that the declaratory and injunctive relief sought by plaintiff is prohibited by the federal tax exception of the Declaratory Judgments Act, 28 U.S.C. §§ 2201–2202, and by the Anti-Injunction Act, 26 U.S.C. § 7421(a). Even if those statutory prohibitions were inapplicable, defendant contends, plaintiff has failed to establish that it is threatened with irreparable harm, a prerequisite to the granting of equitable relief, and on the merits is not entitled to declaratory relief.

I. Case for Controversy

The documents filed in support of plaintiff's motion show that beginning about April, 1977, the Internal Revenue Service ("IRS") issued a series of News Releases announcing that governmental units maintaining employee pension benefit plans must file annual returns with the IRS pursuant to Code Section 6058(a), regardless of whether there has been a determination that the plans are qualified. In subsequent releases, the IRS reduced the amount of information required of governmental plans and extended the filing date. Under regulations promulgated by the IRS and published on July 7, 1978, 43 Fed. Reg. 29291, returns for the years 1975-1977 are to be filed by September 1, 1978, and penalties waived for all returns filed by that date. The reporting requirements for governmental plans were limited to items one through seven, nine, ten (a)–(d), eleven and seventeen of Form 5500.

The parties agree that there is a present controversy over defendant's authority to require plaintiff and its agencies to file annual information returns with respect to employee pension plans maintained by them. While plaintiff's request for preliminary injunctive relief is directed primarily at the imposition of penalties, it does not appear necessary to reach that issue. No penalties having been imposed, that issue is not ripe for decision. Instead, the Court will treat plaintiff's motion as one for declaratory relief directed to defendant's power to require plaintiff to file annual information returns pursuant to Code Section 6058(a).[2] With respect to that requirement, the Court finds that a justiciable controversy exists with respect to which the Court has jurisdiction to grant declaratory relief, 28 U.S.C. §§ 1331(a), 1340, 2201; *Aetna Life Ins. Co.* v. *Haworth*, 300 U.S. 227 (1937); *Maryland Casualty Co.* v. *Pacific Coal & Oil Co.*, 312 U.S. 270 (1941), unless barred by the federal tax exception of the Declaratory Judgments Act.[3]

None of the other issues raised in the complaint presents a justiciable case or controversy. Plaintiff argues that the threat of future taxation, with the possibility of retroactive application, creates a present controversy under *Lake Carriers' Assn.* v. *MacMullan*, 406 U.S. 498 (1972). Even assuming the argument to

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[1] This requirement is found in Section 6058 of the Code which provides, in relevant part:

"(a) In general.—Every employer who maintains a pension, annuity, stock bonus, profit-sharing, or other funded plan of deferred compensation described in part I of subchapter D of chapter 1, or the plan administrator (within the meaning of section 414(g)) of the plan, shall file an annual return stating such information as the Secretary may by regulations prescribe with respect to the qualification, financial condition, and operations of the plan; except that, in the discretion of the Secretary, the employer may be relieved from stating in its return any information which is reported in other returns."

* * * * * * *

"(c) Employer.—For purposes of this section, the term 'employer' includes a person described in section 401(c)(4) and an individual who establishes an individual retirement account or annuity described in section 408."

26 U.S.C. § 6058.

[2] It is, of course, also unnecessary to reach other issues concerning the power of the federal government to regulate or control pension plans maintained by states or their agencies. Those issues are not ripe for decision in this litigation inasmuch as defendant has acted, or threatened to act, only with respect to the filing of annual information returns. Nor need the Court be concerned with potential burdens on plaintiff should defendant require the filing of returns more elaborate and burdensome than those currently required.

[3] Defendant contended initially that he had not been properly served. The file now indicates, however, that defendant was served by certified mail and that, in addition, the United States Attorney in Sacrameno was personally served. Thus, service appears to have been sufficient. 28 U.S.C. § 1391(e); F. R. Civ. P. Rule 4(d)(4), (5).

have merit, it proves too much If the threat of taxation created a controversy, that controversy, unlike that over the required filing of information returns, would clearly be one with respect to the assessment and imposition of federal taxes and subject to the usual assessment and refund procedures. Thus, the case would fall within the tax exemption of the Declaratory Judgments Act and would also be barred by the Anti-Injunction Act. All claims except those related to the Section 6058(a) filing requirements must therefore be dismissed without prejudice for lack of jurisdiction.

II. Applicability of the Federal Tax Exception of the Declaratory Judgments Act

By amendment adopted in 1935,[4] Congress excluded controversies "with respect to Federal taxes" from the scope of the Declaratory Judgments Act of 1934.[5] The Court must therefore determine whether the controversy over the reqiurement under Code Section 6058(a) that annual information returns be filed is a controversy with respect to federal taxes.

The information called for by Form 5500 is general rather than financial in nature. The filing requirement is a part of a broad federal scheme of pension plan reform incorporated in ERISA. The legislative history of ERISA indicates that one purpose of requiring employers to file annual information returns, which are open to public inspection, was to enable plan participants and beneficiaries to obtain information needed to enforce their plan rights and to oversee the obligations owed by fiduciaries to the plans generally.[6] Another purpose mentioned in the history, and stressed by defendant, is to provide the IRS with annual statistical data for its evaluation and to provide information to the Department of Labor.[7] Whatever the primary purpose of the requirement, however, the statutory authority is found in the Internal Revenue Code. *See, Bob Jones University* v. *Simon*, 416 U.S. 725, 740 (1974). The form, moreover provides the IRS with information which still assist it in keeping track of governmental plans and determining the taxability of benefits paid and income incurred by governmental plans. *Lewis* v. *Sandler*, 498 F.2d 395, 399 (4th Cir. 1974). An order relieving plaintiff from having to file Form 5500 would to some extent hamper the Government's ability to assess and collect taxes, and to protect its revenue in general. It follows that plaintiff's claim for declaratory relief would be barred by the federal tax exception of the Declaratory Judgments Act unless special circumstances make it inapplicable.

No taxes or penalties have been assessed against plaintiff nor is assessment imminent or threatened. Plaintiff is therefore subject to the reporting requirement, without having access to any assessment and refund procedures in which the requirement can be challenged.

The question whether the Anti-Injunction[8] and Declaratory Judgments Acts will bar relief in a tax controversy when the plaintiff has no adequate alternative forum in which to challenge the validity of IRS action was explicitly left open in *Bob Jones, above*, 416 U.S. at 746 and 747, n. 21. The Court of Appeals relied upon this exception in *Eastern Kentucky Welfare Rights Org.* v. *Simon*, 506

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[4] Amendment of August 30, 1935, 49 Stat. 1027.

[5] The Act of June 14, 1934, 48 Stat. 955, 28 U.S.C. §§ 2201–2202 provides:

"§ 2201. Creation of remedy.

"In a case of actual controversy within its jurisdiction, except with respect to Federal taxes, any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

"§ 2202. Further relief.

"Further necessary or proper relief based on a declaratory judgment or decree may be granted, after reasonable notice and hearing, against any adverse party whose rights have been determined by such judgment."

[6] 1974 U.S. Code Cong. & Ad. News 4639, at 4827.

[7] Id. at 4919.

[8] The Act of Mar. 2, 1867, § 10, 14 Stat. 475; Rev. Stat. § 3224 (1874); Int. Rev. Code of 1939, § 3653. Section 7421(a) of the Internal Revenue Code of 1954 states:

"Except as provided in sections 6212(a) and (c), 6213(a), and 7426(a) and (b)(1), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."

In *Bob Jones University* v. *Simon*, 416 U.S. 725, 733, n.7 (1974) and in *Commissioner* v. *"Americans United" Inc.*, 416 U.S. 752, 759, n.10 (1974), the Supreme Court held the federal tax exception of the Declaratory Judgments Act to be at least as broad as the Anti-Injunction Act. Thus, any claim for relief falling within the prohibition of the Anti-Injunction Act is also within the tax exception to the Declaratory Judgment Act. (*See* note 10, below.)

F.2d 1278 (D.C. Cir. 1974), *vacated*, 426 U.S. 26 (1975) (on the ground that plaintiffs failed to establish their standing to sue, without reaching the question whether the action was barred by the Declaratory Judgments or Anti-Injunction Acts). The district court had granted summary judgment to plaintiffs (various health and welfare organizations and indigent persons), holding that private nonprofit hospitals seeking tax exempt status as charitable organizations must provide free or low cost treatment to individuals unable to pay for such services, and invalidating the revenue ruling which modified that requirement. Defendant-appellant argued that the district court lacked jurisdiction because the action was barred since plaintiffs were seeking to force the Government to impose a tax on Judgments Act. The Court of Appeals held, however, that the action was not barred since plaintiffs were seeking to force the Government to impose a tax on the contributors to certain hospitals, not to prevent assessment of a tax, and had no other adequate legal remedy.[9]

Defendant argues that because plaintiff may refuse to file Form 5500, incur a penalty under Code Section 6652, and then contest payment of that penalty, plaintiff has an adequate legal remedy. That argument was rejected by Judge Bryant in *National Restaurant Ass'n* v. *Simon*, 411 F. Supp. 993 (D.D.C. 1976), where a group of trade associations sought to enjoin the IRS from implementing a ruling requiring employers to include on the employee's W–2 form the amount shown by the employer's records to have been paid to the employee in charge tips. Plaintiffs claimed that the requirement conflicted with other provisions of the Internal Revenue Code and that the IRS failed to follow proper rulemaking procedures. Defendants moved to dismiss on the ground the action was barred by the Anti-Injunction Act. The court decided that the action was within the Anti-Injunction Act but that because it would have left the aggrieved party with out access to judicial review, the Act was not intended to apply to such a situation. Noting that under the Anti-Injunction Act, initial IRS determinations are ordinarily not reviewable until the enforcement stage, the court explained:

"In the normal case, the enforcement stage means refund litigation: a taxpayer may either pay a disputed sum and sue for a refund, or refuse to pay the sum and defend against a government suit in the Tax Court. Here however plaintiffs are not faced with the usual assessment process, but rather with an administrative determination that existing regulations require them to report certain information about payments to employees. Significantly, no sum of money is at issue in any facet of the requirement, and consequently the ordinary options of refund litigation are not available to plaintiffs. Put another way, there is no enforcement process to which to look for judicial review. While the Supreme Court has held that the delay occasioned by postponing review until refund litigation does not pose constitutional problems, it has nowhere held or implied that such problems could be avoided if a judicial forum was absent altogether." (411 F. Supp. at 996)

The court then rejected the Government's suggestion that the penalty provisions of Code Section 6652 afforded plaintiffs an adequate legal forum in which to contest the validity of the reporting requirement:

"It puts the plaintiffs in the untenable position of either complying, with no judicial review, or of defying the government's interpretation of their legal obligations under the code, of being in essence a lawbreaker. The Court cannot imagine that the Congress intended such an anomalous result in a system which depends for its very existence on the principle of voluntary compliance. Nor does the Court believe that Congress intended to condition access to any judicial review of such a revenue ruling on subjecting oneself to a fine. In order to test the instant ruling, plaintiffs would become liable for a fine for each W–2 they failed to

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[9] The court reasoned that obviously neither the tax exempt charitable hospitals nor their contributors would institute refund litigation because the contributions were tax-free. 506 F. 2d at 1284.

The court also relied on *McGlotten* v. *Connally*, 338 F. Supp. 448 (D.D.C. 1972) (three-judge court), a case in which the district court rejected the defendant's contention that the Anti-Injunction Act barred a nontaxpayer from challenging the exempt status of a fraternal organization with racially discriminatory membership policies. In *McGlotten* the court stated:

"Plaintiff's action has nothing to do with the collection or assessment of taxes . . . The preferred course of raising his objections in a suit for refund is not available. In this situation we cannot read the statute to bar the present suit." (338 F. Supp. at 453–454)

See also *Investment Annuity, Inc.* v. *Blumenthal*, 437 F. Supp. 1095, 1099–1101, and Supplementary Order at 1103 (D.D.C. 1977), where the court relied on the no access to judicial review exception raised by the Supreme Court in *Bob Jones* and held that the Anti-Injunction Act was not intended to preclude pre-enforcement review of Service action when the action will otherwise never be subject to judicial review.

complete properly. This is money not due to government in taxes, but rather is an extra sum the plaintiffs would apparently be required to risk merely to test the validity of a reporting and information requirement. This risk is not found in the ordinary refund litigation procedure. The Court therefore concludes, in light of these considerations and the obvious constitutional problems they may raise, that the Anti-Injunction Act was not intended to, and does not apply in such a situation."

(Id.)

Defendant argues that even if plaintiff's claim, under *National Restaurant Ass'n*, is not barred by the Anti-Injunction Act, it is barred by the allegedly broader federal tax exception of the Declaratory Judgments Act. The question whether the Declaratory Judgments Act is more preclusive than the Anti-Injunction Act was raised, but left unanswered in *Bob Jones and Commissioner* v. *"Americans United" Inc.*, 416 U.S. 752 (1974).[10] For purposes of this decision, it is necessary only to hold that the lack of an adequate alternative forum exception, raised in *Bob Jones* and adopted in *National Restaurant Ass'n*, should apply to claims for declaratory relief as it does to claims for injunctive relief, no reason appearing for making a distinction.[11]

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[10] There the Supreme Court stated:

"Some have noted that the federal tax exception to the Declaratory Judgment Act may be more sweeping than the Anti-Injunction Act. E.g., E. Borchard, Declaratory Judgments 855 (2d ed. 1941); Bittker & Kaufman, . . . [Taxes and Civil Rights: 'Constitutionalizing' the Internal Revenue Code 82 Yale L. J. 51 (1972)] at 58. See S. Rep. No. 1240, 74th Cong., 1st Sess., 11 (1935). The Service takes that position in this case. . . . There is no dispute, however, that the federal tax exception to the Declaratory Judgment Act is at least as broad as the Anti-Injunction Act. Because we hold that the instant case is barred by the latter provision, there is no occasion to resolve whether the former is even more preclusive."

(*Bob Jones*, above, 416 U.S. at 733)

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"The Court of Appeals also held that the scope of the 'except with respect to Federal taxes' clause of the Declaratory Judgment Act, see n. 8, *supra*, is coterminous with the Anti-Injunction Act ban against suits 'for the purpose of restraining the assessment or collection of any tax' despite the broader phrasing of the former provision. 155 U.S. App. D. C. 284, 291, 477 F. 2d 1169, 1176. While we take no position on this issue, it is in any event clear that the federal tax exception to the Declaratory Judgment Act is at least as broad as the prohibition of the Anti-Injunction Act. Because we hold that the latter Act bars the instant suit, there is no occasion to deal separately with the former."

(*Americans United*, above, 416 U.S. at 752)

Prior to the *Bob Jones* and *Americans United* cases, a number of courts construed the federal tax exception of the Declaratory Judgments Act and the Anti-Injunction Act as having coterminous application. *See, e.g., Tomlinson* v. *Smith*, 128 F.2d 808, 811 (7th Cir. 1942); *McGlotten* v. *Connally*, 338 F. Supp. 448, 452–453 (D.D.C. 1972) (three-judge court); and *Jules Hairstylists of Maryland, Inc.* v. *United States*, 268 F. Supp. 511, 515 (D. Md. 1967), *aff'd*, 389 F. 2d 389 (4th Cir.), *cert. denied* 391 U.S. 934 (1968).

Since the *Bob Jones* and *Americans United* decisions the D.C. Circuit has held, as it did in *Americans United*, that Congress intended the two statutes to be coterminous. *Eastern Kentucky Welfare Rights Org.* v. *Simon*, 506 F. 2d 1278, 1283–1286 (D.C. Cir. 1974), *vacated*, 426 U.S. 26 (1976). The court based its conclusion upon a reexamination of the legislative history of the 1935 Amendment to the Declaratory Judgments Act found in S Rep. No. 1240, 74th Cong., 1st Sess. 11 (1935):

"Your committee has added an amendment making it clear that the Federal Declaratory Judgments Act of June 14, 1934, has no application to Federal taxes. The application of the Declaratory Judgments Act to taxes would constitute a radical departure from the long-continued policy of Congress (as expressed in Rev. Stat. 3224 [the Anti-Injunction Act, as formerly numbered] and other provisions) with respect to the determination, assessment, and collection of Federal taxes. Your committee believes that the orderly and prompt determination and collection of Federal taxes should not be interfered with by a procedure designed to facilitate the settlement of private controversies and that existing procedure both in the Board of Tax Appeals and the courts affords ample remedies for the correction of tax errors."

To the same effect, *see* H. Rep. No. 1885, 74th Cong., 1st Sess. 13 (1935).

The Court of Appeals' conclusion may be further supported by the observations of Professor Borchard, Co-Draftsman of the Federal Declaratory Judgments Act. He questioned the necessity and purpose of the amendment and advocated a coterminous construction:

"While no precise place for declaratory relief in the scheme of federal tax procedure had been worked out when the Federal Declaratory Judgments Act was adopted in 1934, it was an error for Assistant Attorney General Wideman to suggest to the Senate Committee on Finance in 1935 that Congress intended to apply the Act to matters of private law and that tax matters were intended to be excluded. A simple reading of the Senate Report on the Declaratory Judgments Act and an examination of the first edition of this book should have refuted so unfounded an assumption. But the Department of Justice moved the Congress, without participation in the regular hearings and without opportunity for opponents to be heard, to amend the Federal Declaratory Judgments Act so as to exclude from its scope all actions involving 'federal taxes.' . . .

"But the Government's argument for the amendment of 1935, while suggesting that the declaration was a circumvention of Section 3224 in the matter of income tax assessment,

III. The Interpretation of Section 6058(a)

On the face of it Section 6058(a) appears to be applicable to plaintiff. Section 6058(a) by its terms is applicable where the employer maintains a funded plan described in part I of subchapter D of chapter 1 of the Internal Revenue Code (Code Section 414(d)) which includes a "governmental plan." [12] The definition of employer provided in subsection (c) of Section 6058 neither excludes nor includes government employers expressly.[13] Plaintiff, of course, is an employer in the sense that it has employees; it maintains several funded plans of deferred compensation described in part I of subchapter D of chapter 1 as governmental plans; and neither plaintiff nor its plans are expressly exempted from subsection (a) although their plans are expressly exempted from other ERISA provisions.

Reference to the preceding Section 6057, which requires the filing of registration statements (as opposed to information returns) discloses that the requirement is imposed only with respect to plans to which the vesting requirements of ERISA apply. Governmental plans are specifically exempted from those requirements. 29 U.S.C. §§ 1002(32), 1003(b)(1), 1051, 26 U.S.C. § 411(e). Thus, Congress spoke directly when it meant to exclude governmental plans from the scope of any of the ERISA requirements, a conclusion which is confirmed generally by the coverage provisions of 29 U.S.C. §§ 1081 and 1101, expressly exempting governmental plans from various other ERISA requirements by reference to the Section 1003(b)(1) exemption.[14]

If, as plaintiff contends, Congress intended to exclude governmental plans from the Act entirely, Congress could easily have provided a blanket exclusion.

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goes much beyond the reason advanced in its support and denies the possibility of challenging federal taxes of any kind on any ground by declaratory action. On its face, it might seem that while injunction may still be granted within numerous exceptions to Section 3224, the milder declaration could not be granted. This would be anomalous. *A sounder view would make the prohibition of declaratory judgments in tax cases cover precisely the ground reserved against injunction by Section 3224 and no more, thus merely preventing the use of the declaratory judgment to escape the now limited restrictions of Section 3224.* Even this is pretty harsh, since the need for equitable relief is a condition of injunction but not necessarily of a declaratory judgment. But at least such a construction would limit the destructive and anti-social effects of the Amendment of 1935." (footnotes omitted, emphasis supplied)
(E. Borchard, Declaratory Judgments 850, 855, (2d ed. 1941))

[11] Indeed a stronger argument can be made for applying the exception to permit claims for declaratory relief. Generally speaking, existence of an adequate alternative legal remedy precludes the granting of equitable relief; it would not, however, preclude the granting of declaratory relief. 28 U.S.C. §§ 2201–2202, Fed. R. Civ. P. 57; *Pacific Indemnity Co.* v. *McDonald,* 107 F.2d 446, 448 (9th Cir. 1939).

The Court is aware of *Crouch* v. *C.I.R.,* 447 F. Supp. 385 (N.D. Cal. 1978), where the plaintiff tax preparer sought relief against compelled disclosure of his Social Security number on the ground that it violated his constitutional privacy interests. From what appears in the opinion in that case, plaintiff sought only to enjoin the IRS from enforcing the Section 6695(c) penalty provision and did not seek declaratory relief as to the statutory and constitutional validity of the underlying disclosure requirement found in Section 6109(a)(4) of the Code. The court held that in light of Code Section 6671, the penalty imposed by Section 6695(c) is a tax within the meaning of the Anti-Injunction Act. Without discussing the *National Restaurant Ass'n* case or the adequate alternative forum exception, the court dismissed the action on the ground it was barred by the Anti-Injunction Act.

The case appears to be distinguishable. Here the Court has already dismissed, for lack of jurisdiction, plaintiff's claim for injunctive relief against imposition of a penalty under Code Section 665. Unlike plaintiff in *Crouch,* plaintiff here seeks declaratory relief with respect to the underlying but separate reporting requirement of Code Section 6058(a) (violation of which may trigger a Section 6652 penalty).

[12] (d) Governmental plan.—For purposes of this part, the term 'governmental plan' means a plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. The term 'governmental plan' also includes any plan to which the Railroad Retirement Act of 1935 or 1937 applies and which is financed by contributions required under that Act and any plan of an international organization which is exempt from taxation by reason of the International Organizations Immunities Act (59 Stat. 669).
26 U.S.C. § 414(d).

[13] See note 1, above.

[14] Review of the legislative history, 1974 U.S. Code Cong. & Ad. News 4639–5190 and S. Rep. No. 1090, 93d Cong., 2d Sess. (1974), has disclosed no evidence of an intention to exempt governmental or non-qualified plans from the Act entirely or from the scope of section 6058(a) specifically. To the extent it indicates anything at all, the history, like the statutory scheme itself, indicates an intention to grant both governmental and non-qualified plans limited exemption only from certain specified provisions of the Act. It also indicates that Congress was very much concerned with the question how far it should go in imposing ERISA requirements on governmental plans. With that preoccupation manifest, one cannot say that section 6058(a) is ambiguous with respect to its applicability to governmental plans.

Instead it provided specific, limited exemptions from certain ERISA requirements, none of which apply to Section 6058(a). The failure to provide an exclusive or exemption under that section compels the conclusion that Congress intended the Section 6058(a) reporting requirement to apply to employers maintaining governmental plans, i.e. government employers.

Nor is there any basis for limiting the applicability of Section 6058(a) to employers maintaining qualified plans. The section refers to plans *described* in part I of subchapter D of chapter 1 of the Internal Revenue Code. That part describes nonqualified as well as qualified plans. The scope of ERISA itself is, of course, not limited to qualified plans—its remedial provisions are intended to reach deferred compensation plans generally. *See, e.g.* 29 U.S.C. § 1002 (1) and (2). Again, when Congress chose to limit the application of a provision to qualified plans, it did so expressly. *See e.g.* 26 U.S.C. §§ 219(b)(2)(A)(i) and 401(a). Therefore, the fact that plaintiff's plans may be nonqualified does not exclude the plans from the scope of Section 6058(a).

Counsel for plaintiff has directed the Court's attention to Code Section 6058(b) which provides that:

"Not less than 30 days before a merger, consolidation, or transfer of assets or liabilities of a plan described in subsection (a) to another plan, the plan administrator (within the meaning of section 414(g)) shall file an actuarial statement of valuation evidencing compliance with the requirements of section 401(a)(12)."

It is urged that reference to Code Section 401(a)(12), the final paragraph of Section 401(a) following subsection (21), and Section 411(e) demonstrates that the reporting requirement imposed by subsection (b) in the event of a merger is inapplicable to governmental plans because Section 401(a)(12) applies only to plans to which the vesting standards of Section 411 apply, and the provisions of Section 411, other than Section 411(e)(2), do not apply to governmental plans. Therefore, says plaintiff, if subsection (b) does not apply, the distinct reporting requirement of subsection (a), which is imposed annually regardless of whether or not a merger has occurred, likewise does not apply to governmental plans.

While plaintiff's argument raises an interesting but abstract question whether Section 6058(b) may validly impose a requirement of compliance with Section 401(a)(12) on plans otherwise not subject to that requirement, it does not establish that governmental plans must be excluded from Section 6058(a). The reference in subsection (b) to plans described in subsection (a) does not compel the conclusion that if governmental plans must, for the sake of consistency, be exempted from subsection (b), they must also be exempted from subsection (a). Moreover, since the reporting requirement imposed by subsection (a), as opposed to subsection (b), does not appear to be inconsistent with any other provision of ERISA, the Court sees no reason to alter its conclusion that Congress did not intend to exempt government employers from the reporting requirement imposed by Section 6058(a).

IV. The Impact of the Tenth Amendment

The tenth amendment to the Constitution reserves to the States the powers not delegated to the United States nor prohibited to the States. In its most recent decision in this area the Supreme Court held that among the powers reserved to the States as sovereign entities is the power to determine the compensation of persons employed to carry out the States' governmental functions. National League of Cities v. Usery, 426 U.S. 833, 845 (1976). The Court held this power to be "essential to the separate and independent existence" of the States, and hence one with respect to which Congress may not abrogate the States' plenary authority. 426 U.S. at 851–852.

The instant case is a far cry from one involving 'fundamental employment decisions upon which [the States'] systems for performance of [their governmental] functions must rest. . ." 426 U.S. at 851. All that is before the Court is the validity of the requirement that plaintiff file annual information returns. Defendant has not sought to impose any requirements which would affect plaintiff's management or operation of its pension plans. Unlike in National League of Cities, application of the Section 6058(a) reporting requirement to the States will not withdraw from them the authority to make any fundamental employment decision, nor will it limit the States' ability to structure employer-employee relationships.

Section 6058(a) merely requires every employer (including government employers) maintaining a funded plan of deferred compensation to file an annual

information return. Examination of the Form 5500 items which plaintiff would be required to complete discloses that they call for information which plan administrators are likely to have at hand and thus can readily furnish. Plaintiff has made no showing that completion of those few items would be either unduly burdensome or impractical.

Plaintiff cites no authority, and the Court is aware of none, which precludes the federal government from requiring state governments and agencies to file information returns in their capacity as employers. Apparently, the various States and their agencies have for years complied without challenge with the employment tax provisions of the Internal Revenue Code, involving withholding and reporting. 26 U.S.C. § 3404. The instant requirement is no more intrusive. Furthermore, that the federal income tax laws, when applied to the income of State employees, may have an adverse impact on the States in the discharge of their governmental functions is no ground for invoking the tenth amendment. Helvering v. Gerhardt, 304 U.S. 405 (1938). *See also Wilmette Park District* v. *Campbell*, 172 F.2d 885 (7th Cir. 1949), *aff'd*, 338 U.S. 411 (1949). That compliance with Section 6058(a) will increase to some extent the expense of state operations does not make the requirement violation of the Constitution. Such burdens are but normal incidents of the organization within the same territory of two governments, each possessed of the taxing power. (*Helvering*, above, 304 U.S. at 422)

The Court concludes that plaintiff's constitutional objections to the filing of Form 5500 are without merit.

Plaintiff is faced with no action, or threatened action, by defendent other than the imposition of a lawful reporting requirement. Accordingly, insofar as plaintiff seeks declaratory relief against the application of Section 6058(a) to its plans, the motion is denied on the merits. In all other respects, the complaint is dismissed for lack of jurisdiction.

IT IS SO ORDERED.

WILLIAM W. SCHWARZER,
United States District Judge.

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Public Pension Benefit Protection Litigation and the Courts As Protectors of Participants' Rights

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and
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The legal rights of public pension plan participants, like those of their private sector counterparts prior to ERISA, are controlled primarily by state and local law. Existing protections are far less than they should be. Confused, ambiguous statutes and legal theories lead to great uncertainty. Public pension plan participants, faced with a sudden or unexpected reduction in anticipated benefits resulting from a change in their pension plan, have no readily available, inexpensive legal remedy.

A 1976 Congressional Task Force study of public pension plans reported that:

> ... [the] distinguishing characteristic of governmental pension plans is the unclear legal status of the participants' rights in such plans under state law. Our hearings and studies indicate that the exact nature of the participants' entitlement — contractual, gratuitous, and such, is seldom made clear in the various governmental plans. Further, these interests in plans are frequently subject to various ambiguous

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This article is based on a chapter from a forthcoming book on the reform of public employee pension plans. The book is tentatively entitled *The Public Pension Crisis: Myth, Reality, Reform.* It will be published later this year by the American Federation of State, County and Municipal Employees.

> and conflicting statutory and constitutional provisions. This legal uncertainty also has been shown to involve other elements of the public plan system, particularly in the areas of (1) standards which plan officials must meet in their conduct, and (2) remedies which are available to aggrieved participants and beneficiaries.[1]

In March 1977, the *Harvard Law Review* examined public pension law and agreed with the Task Force's conclusions that public plan growth in recent years "has generally taken place apart from any legislative or judicially imposed controls."[2] This view has been reinforced by a number of general studies of the legal rights of public pension plan participants.

In 1968, law professor Rubin Cohn, writing in the *Illinois Law Review,* found that "the blunt fact is that the law [of public pensions] is contradictory and confusing; more disturbingly, it is immature, and, with few exceptions, it is based on contrived and unconvincing logic." Cohn summarizes his detailed study of court decisions in the area, observing that:

> Despite the contradictions there is a beguilingly deceptive facade of principle. The decisions abound in classic legal concepts. Thus the "rights" are "contractual" or "vested" or "noncontractual" and "nonvested"; they are "gratuities" or "earned but deferred compensation"; and depending on the label which is conveniently appended, these "rights" may or may not be subject to legislative modification. From time to time constitutional limitations which preclude the making of gifts of public monies or the granting of extra compensation require interpretation and application, and the gloss thus imparted to the analysis strengthens the illusion that logic and sound policy are indeed shaping the law. A closer analysis, however, provides a less flattering conclusion. One is left with a nagging notion that the courts are groping for both principle and rationale without comprehending that the quest will be futile as long as they continue routinely and uncritically to apply labels as a substitute for logic and policy.[3]

Levy Anderson reviewed Pennsylvania case law on public pensions for the *Temple Law Review.* Professor Anderson's article discusses legal cases without editorial comment. Nevertheless, Anderson establishes convincingly that even within a single, fairly sophisticated jurisdiction, the principles followed in the decisional law on public pension questions are unreliable. He writes, for example:

> The entire theory of "vested rights" in public retirement benefits is a direct outgrowth of the contractual concept. However, this principle is not followed to its ultimate conclusion by the decisions and is subject to modifications by consideration of public policy.[4]

A full review of the case law in the area reveals inconsistent interpretations of the many different statutory schemes (sometimes hundreds in a single

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1. Pension Task Force, Subcommittee on Labor Standards, Committee on Education and Labor, U.S. House of Representatives, 94th Congress, Second Session, *Interim Report of Activities* (Washington, D.C.: U.S. Government Printing Office, 1976), p. vi.
2. Note, "Public Employee Pensions in Times of Fiscal Distress," 90 *Harv. L. Rev.* 992 (1977).
3. Rubin G. Cohn, "Public Employee Retirement Plans — The Nature of Employees' Rights," 1968 *Ill. L. Rev.* 32 (1968).
4. Levy Anderson, "Vested Rights in Public Retirement Benefits in Pennsylvania," 34 *Temple L. Rev.* 259 (1961); *See also* Note, "Contractual Aspects of Public Pension Plan Modifications," 56 *Col. L. Rev.* 251 (1956).

state!); complicated legal concepts of gratuity, contract, constitutional, and property law are borrowed to simplify the law, but result in increasing the law's confusion; funding and fiduciary obligation rules are also inconsistent and difficult to apply; state and local administrative and public disclosure law play a role which is also complicated.[5]

The final conclusion of such a review shows that public pension law is a quagmire. Lack of uniform, well-developed legislative policy leaves the judicial approach to public pension problem-solving a muddy tangle of cross-currents, backtracks, detours, and special exceptions.[6]

A simple review of some of the basic theories used by pension attorneys underscores the confusion of public pension law. Two theories used traditionally to settle questions raised by state and local government attempts to modify public pension benefits are the gratuity (or gift) theory and the contract (or agreement) theory. The difficulties resulting from these theories have generated a third, the property law theory, which only adds to the confusion.

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5. *See* "Public Sector Pension Law," Annot., 52 A.L.R. 2d 437 (1957) and supps. to 1971.
6. A full review of public sector pension case law is beyond the scope of this article. For those who wish to follow a detailed review of specific cases, a basic outline is provided below.

PENSION PLAN LAW OUTLINE

A. *State Statutory Systems.*
   Robert Tilove, *Public Employee Pension Funds* (New York: Columbia U. Press, 1976).
   Thomas Bleakney, *Retirement Systems for Public Employees* (Homewood, Ill.: Richard D. Irwin, Inc., 1972). "Public Sector Pension Law," Annot., 52 A.L.R. 2d 437 (1957) and supps. to 1977, *see* note 5.

B. *Benefit Theories.*
   Cohn, "Public Employee Retirement Plans — The Nature of Employee Rights," 1968 *U. Ill. L.F.* 32 (1968).
   Anderson, "Vested Rights in Public Retirement Benefits in Pennyslvania," 34 *Temple L. Rev.* 255 (1961).
   Note, "Public Employee Pensions in Times of Fiscal Distress," 90 *Harv. L. Rev.* 992 (March 1977).
   Note, "Contractual Aspects of Pension Plan Modifications," 56 *Col. L. Rev.* 251 (1956).
   Annot., 52 A.L.R. 2d 437 (1957) and supps. to 1976, *see* note 5.

   1. *Gratuity Theory* (Decreasing Majority).
      Richardson v. Belcher, 404 U.S. 78 (1971);
      Fleming v. Nester, 363 U.S. 603 (1960);
      Pennie v. Reis, 132 U.S. 464 (1889); and Annot., above.
   2. *Contract Theory* (Minority).
      (a) Based on State Constitution: Alaska, Illinois, Massachusetts, Michigan and New York.
      (b) Based on Court Decision: Arizona, California, Colorado, Georgia, Pennsylvania and Washington.
      (c) Very rigid in some states, New York, for example, *see Birnbaum v. N.Y. State Teachers Retirement System,* 5 N.Y. 2d 1, 152 N.E. 2d 241, 176 N.Y.S. 2d 984 (1958) and *Sgaglione v. Levitt,* 37 N.Y. 2d 506, 337 N.E. 2d 592, 375 N.Y.S. 2d 79 (1975).
      (d) More flexible, Michigan, *see In re Enrolled Senate Bill 1269,* 389 Mich. 659, 209 N.W. 2d 200 (1973); and California, *see,* for example, *Allen v. City of Long Beach,* 45 Cal. 2d 128, 287 P. 2d 763 (1955); and Pennsylvania, *see Temple L. Rev.,* above.

I. The Gift Theory

The traditional gratuity theory is followed technically in the case law by a majority of the states and the federal government. This theory holds that public pensions are "gifts" of the government, which the government is free to confer, modify, or deny as long as it avoids arbitrary action.[7]

Some states have constitutional provisions against the granting of gifts. It is difficult to reconcile these provisions with the theory that public pensions are "gifts" to public employees. In others, policymakers, legislators, and courts have been disturbed by the obvious inequities of a truly full allegiance to this theory, which would allow a government to void pension promises at any time. It is reasonable for a public employee to plan his retirement around his employer's promise to provide a pension. The hardships caused by the frustration of his reliance on such a promise can generate forceful arguments which undermine vigorous application of the gift theory.

II. The Contract Theory

In an increasing number of states, case and statutory law have adopted a contract theory of public pensions.[8] In some states, the contract theory is embodied in the state constitution.[9] It holds that a government has contracted with its employees to provide certain benefits in exchange for their labor. The contract or agreement, once made, is mutual — both the government and the employee are involved. The government may not change its pension commitment unilaterally without violating the contract.

The contract theory can lend an inflexibility to pension plans which is unrealistic. A New York constitutional provision, which follows the contract theory, for example, has prevented the use of realistically updated mortality tables.[10] The contract theory makes every "crisp word" of a pension statute immutable, at least as it applies to current employees.[11]

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3. *Property Theory.*
   New Jersey. *Spina v. Consolidated Police and Fire Pension Fund Commission.* 21 N.Y. 391, 197 A. 2d 169 (1964).

C. *Funding Litigation.*
1. Philadelphia. *Dombrowski v. City of Philadelphia,* 431 Pa. 199, 245 A. 2d 238 (1968).
2. Washington State. *Weaver v. Evans,* 80 Wash. 2d 461, 495 P. 2d 639 (1972 (en banc)).
3. Illinois. *Illinois Education Assoc. v. Illinois No. 6891* (Ct. Cl. June 25, 1973) *see* 90 *Harv. L. Rev.* 992 (AT).
4. Application of doctrines of separation of powers and sovereign immunity key to cases in this area.

7. *Richardson v. Belcher,* 404 U.S. 78 (1971); *Fleming v. Nester,* 363 U.S. 603 (1960); *Dallas v. Trammel,* 101 S.W. 2d 1009 (1937); *see also* note 6, above.
8. Arizona, California, Colorado, Georgia, Pennsylvania, and Washington, *see also* note 6, above.
9. Alaska, Illinois, Massachusetts, Michigan, and New York.
10. *Birnbaum v. New York State Teachers System,* 152 N.E. 2d 241, 176 N.Y.S. 2d 984 (1958).
11. *See* note 12, below.

In some states, courts have read implied provisions into statutes, allowing "reasonable" changes under the contractual theory. This, again, increases the confusion, since no consistent test has been developed to determine which changes are reasonable and which are not.[12]

III. An Alternative — The Property Rights Theory

The confusion generated by the gratuity and contract theories moved a New Jersey court to reject these theories in favor of more flexibility. In *Spina v. Consolidated Police and Fire Pension Commission,* the court rejected the wooden "one crisp word" implications of the contract theory. The court found that participants had a property interest in their pensions which must be protected, but this may be balanced against other interests. The case dealt with an employee's property rights in funds set aside for pension purposes. The Federal Constitution prevents the taking of property without due process. If public pension rights are property rights, a whole series of complicated legal consequences results. *Spina* ignores the difficult federal due process and constitutional issues raised by the property theory. Whether a property analysis protects participants' rights to promised benefits, rather than merely to pension funds already set aside, is also left unanswered by *Spina.*[13] The theory has not been widely used since this 1964 New Jersey decision.

Conclusion

The actual decisions in these cases are based more on the facts and arguments as presented in a given case than on any generally applied principle.

In a single state, elements of the gratuity, contractual, and property theories can be found. No reliable rules are applied consistently. For example, a destitute widow suffering as the result of a pension administrator's bureaucratic decision is likely (if she can afford to get into court with adequate representation) to find relief in a flexible application of legal principles which might otherwise defeat her claim. On the other hand, a group of police officers, already receiving liberal benefits, are likely to have difficulty winning a lawsuit against a pension plan under fiscal stress, regardless of the theory used.

The law of public pension plans suffers a clear disability — it is blind. The conceptual theories currently available to courts faced with public pension claims are inadequate for solving the problems raised. Without basic legislative policy guidelines beyond those which currently exist, no judicial system will adequately resolve the problems associated with public employee pension rights.

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12. *See,* for example, *In Re Enrolled Senate Bill 1269,* 389 Mich. 659, 209 N.W. 2d 200 (1973); *see also* note 6, above.
13. 41 N.J. 391, 197 A. 2d 169 (1964); and innovative discussion in 90 *Harv. L. Rev.* 1003 (1977).

The *Harvard Law Review* article discussed previously concludes:

> ...that courts should assume an active role in protecting the rights of public employee pension beneficiaries. The wisdom and necessity of such action might be questioned under certain circumstances. First, it has been suggested that principles of fairness and flexibility require legislators and administrators, rather than the courts, to assume greater responsibility for protecting [the obvious] property and just compensation rights [of public pension participants and beneficiaries]. Second, it might be argued that judicial protection is unnecessary because public employees exercise considerable power in the state and local political process... [However] in such circumstances [of fiscal and other pressure on public plans] potential flaws and gaps in the political and legal process may be exploited to the disadvantage of even well-represented groups of citizens. Thus, a gratuity characterized pension benefit and an employer-controlled pension fund, while not normally subjects of great concern, may become escape hatches for a financially pressed government. If so, public employees may suffer disproportionately, simply because it is politically dangerous or impossible for legislators to advocate or attempt a fair and broader spreading of the sacrifice. It is precisely in this situation that it becomes the duty of the judiciary to check the other branches by vigorously enunciating and enforcing legal rights.[14]

Judicial protection of the rights of public employee pension participants and beneficiaries should be reformed — new theories should be developed which fit the realities of today's public pension problems. This should be pressed strongly as part of a broad public pension reform movement. Adequate judicial protection of public pension rights will not develop, however, without the involvement of plan participants, beneficiaries, and their representatives in achieving legislative reform.

14. 90 *Harv. L. Rev.*, 1016f.

STATEMENT OF HENRY BAYER, EXECUTIVE DIRECTOR, DISTRICT COUNCIL 101, AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, AFL–CIO, ACCOMPANIED BY MICHAEL LEIBIG, ATTORNEY, ZWERDLING AND MAURER; AND ROBERT KALMAN, ASSISTANT DIRECTOR OF PUBLIC POLICY, AFSCME INTERNATIONAL

Mr. BAYER. On my left is Mike Leibig of the Washington, D.C. and Detroit, Michigan law firm of Zwerdling & Maurer.

On my right is Bob Kalman, who is assistant director of public policy for the international union.

These gentlemen have coauthored a book which will soon be published on the whole question of public employee pension plans.

Mr. SIMON. Before you give your testimony, if I can just commend it, I believe AFSCME was the only union that took a stand on behalf of the universal social security coverage. I was one of that lonely band of 38 who voted with you. It was a courageous position for you to be taking and I think a right position. I appreciate it.

Mr. LEIBIG. We hope it is going to come up again.

Mr. SIMON. The President just appointed a commission to study that. So I assume that it will once again be a recommendation as it has been of every commission that has ever studied it.

Mr. BAYER. We hope that Mr. Erlenborn will be with us in vote as well as spirit.

You have a copy of my testimony. Rather than read it, because I presume it will be entered in the record, I would like to make some comments about the need for this legislation and the need for it indeed in the State of Illinois. I agree with Senator Egan that the State of Illinois is probably as good or better than any other State, given the State pension plans are in. But even the best at this point is not good enough.

I would like to point out some of the problems that we face here. As was indicated earlier, regarding the current funding of the pension plans in Illinois, there is $7 billion less than what full funding would call for. Also reference has been made to the five largest State pension plans, which cover most employees. But according to our information, over 450 State and local pension plans in the State of Illinois alone. We feel that that number is too large. Perhaps some of the requirements that this law would impose would force pension plans to merge so we wouldn't have the large number which we now have.

Reference has been made to some of the laws on the books regarding pension plans in the State and some of the powers of the Illinois Department of Insurance. In a court case that the teachers entered into, where they said that the pension plans were underfunded and the law required that they be funded, the judge said, "Yes, you are right. They should be." That was it. There was no mechanism for enforcing the law that was on the books.

The State has made a promise to the employees covered by pension plans. When that promise is broken and the employees go to the courts for legal remedy the court says, "Well, there is no remedy."

We are not saying necessarily that the current laws which require full funding are necessary. Perhaps 65 percent, as Senator Egan referred to, would be sufficient to keep these pension plans afloat.

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But you shouldn't make a promise to employees, saying the money is there and then not have it there and then have the courts say, "Well, even though the law is there, you can't have it." If the employees are required by law to put up a certain percentage of their income into the pension plan, they can't say, "Well, my bills are too high this month" or "I didn't get a pay raise that I wanted. Therefore I am not going to put in the 6 percent which the law requires. I am only going to put in 4 percent of my income this year." There is no out for the employees. So we feel the same obligation that the employees are required to meet by law should be placed upon the employer.

The Illinois Department of Insurance does send out to municipalities each year a notice telling them how much money they are required by law to put into the pension plan in order to see that it is funded. Unfortunately many villages just disregard the notice from the Illinois Department of Insurance, either sending it no money or less money than is required. And again, there is no mechanism by which the Illinois Department of Insurance can force the municipality into putting up the money that they are legally required to do.

We have, year in and year out, instances of villages simply disregarding notices which they receive from the Illinois Department of Insurance. So again, it is a question that even though things may look good on the books, in fact there are no mechanisms there to insure that what the law says is lived up to.

Our main areas of concern are of course, one, funding levels. In the State of Illinois we currently have a liability of $7 billion for 450-plus public plans in the State. Second, the standards for the trustees of the pension fund, we don't feel that what we currently have is adequate, that they in any way insure that the funds will be invested in the best interest of the pension plan participants. They simply do not exist here in the State of Illinois.

Finally we do not believe that disclosure of the conditions of these plans is adequate. People are not aware of the conditional nature of the pension plans that they operate under. I think most people operate under the false presumption that the pension that they faithfully contribute to every week or every 2 weeks when they get their paycheck is going to be there when they retire. They have no knowledge that even though they are putting in the amount of money that they are required to each pay period that their employers aren't necessarily doing that. When they reach retirement age they face the real possibility of the money not being there and then having no mechanism for recovering the monies that were supposed to be on deposit in their behalf.

Those are our main areas of concern. We are here to answer any of your questions.

Mr. LEIBIG. I would like to mention one thing. We attached to our testimony two articles that we wrote that were published on these areas. One deals specifically with the difficulty where you have a statutory rules in the public sector that says fiduciaries shall follow good management practices. It is an extremely difficult legal matter to enforce that in the public sector, much more difficult than it is in the private sector.

Even if you have a law in Illinois that sets a certain standard—we are very concerned about that and mention this in the prepared testi-

mony—how do you show it is really a trust? How do you show these people are common law trustees? It is very difficult.

Mr. SIMON. We will enter the article in the record.

Unfortunately we can't get pictures in the record.

Mr. LEIBIG. We have submitted a copy of Judge Schwarzer's decision as mentioned by Professor Schotland. We also agree that that is the best court decision so far that deals with the constitutional issue. It may be the only one.

Mr. SIMON. At some point in the record, either in your testimony or his testimony, it will be entered.

You mentioned a number of cities or villages not complying with the Department of Insurance recommendation. Do you have any idea how many, what percentage?

Mr. BAYER. No; I don't. I do know that the $7 billion liability is there. But part of that of course applies to villages which simply don't tender the full amount as a general practice. I can't give a percentage.

Mr. SIMON. You say it is a general practice not to comply?

Mr. KALMAN. That is what we understand.

Mr. LEIBIG. In Illinois it is not only the villages. The State of Illinois, as has been testified, has not put aside the amount of money the statutes require. The big plans are doing the same thing.

Mr. SIMON. So if Senator Egan is still here, if someone from the staff of the Pension Laws Commission could send us that information, we would insert it in the record here, how many villages and cities actually do comply with the amounts requested.

Mr. EGAN. I will get it from the Department, if they have it.

I will be happy to do it.

Mr. SIMON. Great.

Mr. Erlenborn.

Mr. ERLENBORN. Let me just say thank you, Mr. Bayer and associates, for your support of this legislation. I take it from the tenor of your presentation that you would say even in Illinois this legislation might have a salutary effect.

Mr. BAYER. Yes.

Mr. ERLENBORN. Illinois may not be one of the worst of the States in its management of its public pension funds. But deficiencies may be remedied by the passage of this legislation.

Mr. BAYER. Correct.

Mr. ERLENBORN. I have no further questions.

I assume the chair will excuse you.

Thank you for your testimony.

Next will be Mr. Robert Wilkie, president of the board of trustees, Chicago Teachers' Pension Fund, accompanied by Mr. Ward, James F. Ward, executive director.

[The prepared statement of Mr. Wilkie follows:]

STATEMENT OF ROBERT T. WILKIE, PRESIDENT, BOARD OF TRUSTEES, PUBLIC SCHOOL TEACHERS' PENSION AND RETIREMENT FUND OF CHICAGO

Chairman Dent, members of the Subcommittee on Labor Standards, my name is Robert T. Wilkie and I am President of the Board of Trustees of the Public School Teachers' Pension and Retirement Fund of Chicago. I had almost completed reading the 900 page Dent Report (Pension Task Force Report on Public Employee Retirement Systems) when I was informed that H.R. 14138 had been introduced. We in Chicago diligently attempt to obtain copies of any law that

might affect us. We were first able to read H.R. 14138 just five days ago last Friday. Nevertheless, on short notice, we have read both the Report and this bill.

I wish to make only a general comment on the bill at this time. In the Economic Report of a recent Republican President a persuasive case was made that we have too much federal regulation in the United States and that general deregulation would benefit our overly encumbered national economy. Just the other day a Democratic President told us that it will make economic sense for him to reduce the size of federal government operations as part of an anti-inflationary program.

Now comes a bill that is certainly regulatory and, further, also creates another federal agency, the Employee Benefits Administration. Since this seems clearly contrary to both Presidential statements, I resolved to ask what compelling national interest might require such a bill. To find this I referred to the bill: Title I, Subtitle A, Section 2, Findings and Declaration of Policy.

Approximately forty lines of type are devoted to stating that the problem is a federal one. Two of those lines told me the problem: that some public employees' rights have been "diminished in value because of inadequate safeguarding" and some public employees have been subject to "arbitrary decisions without due process of law."

I am specifically familiar with the Chicago teachers' plan and generally familiar with public retirement plans in the United States. I know of no evidence or assertion that such problems exist for Chicago teachers, and it has been my impression that they do not exist for most public employees in the United States.

I would like to introduce Mr. James F. Ward, Executive Director of our System, who will present some facts showing where we in Chicago stand on the problems alleged by this bill. But, before I do, may I say that I discern an important question of priorities here. I most earnestly ask that you consider these. If you sincerely believe that there are public employees in the United States whose rights are being diminished to any substantial degree or who truly do not have access to due process, then prosecute this type of law. But, if you think the costs of implementation over the many years to come will be inflationary and in excess of alleged "losses," then please do not pass unnecessary and expensive legislation that does not even include a sunset clause in the event it is truly superfluous.

STATEMENT OF ROBERT T. WILKIE, PRESIDENT, BOARD OF TRUSTEES, PUBLIC SCHOOL TEACHERS' PENSION AND RETIREMENT FUND OF CHICAGO, ACCOMPANIED BY JAMES F. WARD, EXECUTIVE DIRECTOR

Mr. WILKIE. Thank you. First of all, Mr. Congressman, I want to thank you on behalf of the Chicago Teachers' Pension Fund for this opportunity to appear today and at least present our point of view.

Mr. Ward is here with me. He is the executive director of our fund. His report will be more or less the substance of our appearance here today.

I do want to make a couple of comments. My main concern with the bill is really what inflationary impact or aspects it would have on our fund. I share Senator Egan's and Al Weinberg's opinion that Illinois is in pretty good shape in comparison to some other funds throughout the country.

One of the things that I think in Illinois we are attempting to do—and this is a concerted effort—is to bring our pension funds up to a more acceptable level of funding. In our own fund in the last 8 years we have grown somewhere around 11 percent in funding. We have gone, from 1971 to 1978, from 31 to 42 percent. So we are making progress in solving our problems.

I just received a copy of this bill last Friday. So consequently we weren't really given too much time as far as the hearing is concerned.

As I say, I am more concerned about the inflationary impact of this matter. We have been holding the line on benefit improvements for our pensioners in this State because of the funding problem. And yet as a pension fund we should certainly have built-in safeguards to keep people in the ball park as far as their pensions not being eroded by inflation.

It has taken us several years to finally get a bill passed which will go into effect this January increasing our pensioners' cost-of-living factor by 1 percent. Certainly considering inflation today that is really a token gesture. But we are holding the line as far as trying to bring our funding responsibilities up to at least an acceptable level.

The only comment I would like to make would be to deal along the line of inflation. I recall in President Ford's economic report—and this is a Republican President—where he made a pretty persuasive case that we have too much Federal regulation in the United States and in general deregulation would benefit our generally overencumbered national economy.

The other day I listened to President Carter, a Democratic President, telling us that it makes economic sense for him to reduce the size of Federal Government operations as part of an anti-inflationary program.

Now comes along this bill which certainly is regulatory and would also create another Federal agency, the Employee Benefits Administration. This seems at least to me contrary to what the President and former President were saying. I asked myself just what compelling national interest might be served by such a bill.

After going through the bill I did find in title I, subtitle A, section 2, Findings and Declaration of Policy, that there are approximately 40 lines of type devoted to stating that the problem is a Federal one. Two of those lines more or less tell me, and I quote, that some public employees' rights have been "diminished in value because of inadequate safeguarding" and, again I quote, that some public employees have been subject to "arbitrary decisions without due process of law."

I happen to be more familiar with the Chicago plan than most other plans. I can find no evidence that anything in that applies to the Chicago Teachers' Pension Fund. And as I travel throughout the country attending many pension conferences I find very little evidence that this problem exists for most of the public employee pension funds throughout the country.

You have alluded to New York and Pennsylvania. And I would agree.

I have Mr. Ward here now, who will present his report.

I would just like to say that if you sincerely believe that these abuses do exist throughout the United States, where the rights of public employees are being diminished, to a great degree, let's say, and that they are being denied access to due process, I probably would encourage the enactment of such a bill. At the present time I really am not that convinced.

In fact, an interesting item I came across the other day in a Merrill Lynch report, which suggested that since 1974 under ERISA there have been upwards of 30 percent of private employee pension funds that have disappeared since ERISA and some of them were very well-managed funds.

There seems to be very little action since ERISA of encouragement of companies really to initiate and promote new pension funds. That is just a comment I came across the other day in a Merrill Lynch report.

At this time I would like to introduce Mr. Ward, who as I said will present the substance of our report.

[The prepared testimony of Mr. Ward follows:]

TESTIMONY OF JAMES F. WARD, EXECUTIVE DIRECTOR, PUBLIC SCHOOL TEACHERS' PENSION AND RETIREMENT FUND OF CHICAGO

My comments will consist of two parts. The first is a description of the Chicago teachers' plan, and the second is an indication of how H.R. 14138 would affect our system. Our plan is the oldest teachers' pension fund in the United States. We have consistently been functioning since 1895, continuously improving benefits and operation, and never missing a pension payroll for over 80 years.

PLAN DOCUMENT

The Plan Document governing the administration of the Public School Teachers' Pension and Retirement Fund of Chicago is contained in Article 17 of the Illinois Pension Code (Chapter 108½, Illinois Revised Statutes). The statute provides for the administration of the pension plan and contains in detail membership, benefits, qualifying conditions, employee and employer contribution rates, guidelines for investing funds, selection and responsibilities of trustees, and custodian of funds. This Article also contains reference to Article 20 of the Illinois Pension Code which provides for the continuity and preservation of pension credit in the case of employees transferring employment from one governmental unit of the state to another.

PLAN ADMINISTRATION

The Public School Teachers' Pension and Retirement Fund of Chicago is administered by a Board of Trustees composed of nine members. Three members of the Chicago Board of Education are appointed by the Board of Education to our board for a term of 2 years (two are appointed in odd-numbered years and one in even-numbered years). Six members are elected by the contributors for a 3-year term. This is an annual election, electing two trustees each year. This has been the composition of the Board of Trustees since 1909.

PLAN PARTICIPATION

Members of the teaching force of the Chicago Public Schools, numbering over 30,000, including teachers, administrators and all other persons whose employment requires a teaching certificate issued by the Chicago Board of Examiners, and employees of the Fund, are required to contribute 8 percent of salary to the Fund. Persons on an hourly basis or temporary teachers working less than 5 days in a pay period do not contribute to the Fund. Membership is a condition of employment and is compulsory.

VESTING

A contributor of the Public School Teachers' Pension and Retirement Fund may resign after 5 years of service and qualify for a pension at age 62. The vesting provision is more liberal than the provision in ERISA.

BENEFIT STRUCTURE

1. Service retirement pensions

Pensions after 20 years of service are paid on a percentage of average salary based on the following formula: 1.67 percent for each of the first 10 years of service; 1.90 percent for each of the next 10 years of service; 2.10 percent for each year of service in excess of 20 but not exceeding 30; and 2.30 percent for each year of service in excess of 30 to a maximum of 45 years. Average salary is the highest consecutive 4 years within the last 10 years of service. The result is base pension with a maximum of $1,500 per month or 75 percent of average salary, whichever is greater.

2. Disability retirement pensions

After a minimum of 10 years of service a contributor may apply for a permanent disability retirement pension provided application has a physician's certification. The Fund appoints two additional physicians to certify that the applicant is presumably permanently incapacitated for service.

3. Survivors' benefits

The Fund also provides a single-sum death benefit to both contributors and annuitants and a survivors' monthly benefit.

4. Reversionary pensions

An optional reversionary pension may be exercised (any time prior to retirement) by any contributor by taking a lesser amount of service retirement pension and providing with the remainder of his equity, determined on an actuarial equivalent basis, a reversionary pension benefit for any person named in a written designation filed by the contributor.

5. Refund of contributions

Four months after permanent separation from service a member may apply for a refund of contributions. All employee contributions are refunded without interest, at which time the member shall have no further interest in the Fund. If a member accepts a refund of contributions and at a later date returns to teaching, provisions are made to repay contributions and re-establish service credit.

REPORTING AND DISCLOSURE

Each employee is provided with a copy of "Pension Facts" and a set of brochures. These basically provide the member with the operation of the Fund, summarizing the benefit and contribution provisions, and giving contributors information regarding their rights, privileges and obligations in the Fund.

The proceedings of each trustees' meeting are published in detail and distributed to each school.

Bulletins are sent to the schools periodically to keep the contributors informed of legislative matters, new items and any administrative changes affecting the operation of the system.

An annual report is printed for distribution after an independent certified public accounting firm audits the records and financial status of the Fund. The independent auditors also make recommendations for changes in recordkeeping and procedures.

Actuarial statistics are reported and published as a supplement to the annual report which tabulate age, service, salary and other characteristics of the contributors and statistics relating to service, disability retirement and survivor pensioners. This constitutes 69 tables of accumulated membership data. The availability of the statistics in a cumulative form for a number of years enhances their value in an analysis and interpretation of the results of operations of the Fund.

At the end of each fiscal year each member is provided with a detailed statement of his account, which gives his accumulated contributions and his years of service with an explanation of contributions.

The By-laws and Rules of the Board of Trustees are also published.

STATE DEPARTMENT OF INSURANCE

Article 22 of the Illinois Pension Code requires that each public employee retirement system submit to the State Department of Insurance each year a financial balance sheet statement of income and expenditures, an actuarial balance sheet, statistical data reflecting age, service and salary characteristics concerning all participants and pensioners, special facts concerning disability and other claims, details on investment transactions, administrative expenses and such other supporting data and schedules which in the judgment of the Department may be necessary for a proper appraisal of the financial condition of the system.

Article 22 of the Illinois Pension Code provides that the Director of Insurance shall call to the attention of the State Attorney General violations of the Code, and the Attorney General shall take whatever legal steps are necessary to force the governing body, pension system of public officials covered by the Code to comply with the provisions of the Illinois Pension Code.

FUNDING

The Public School Teachers' Pension and Retirement Fund of Chicago is funded through a combination of four major sources:

1. *Member contributions.*—Each member has deducted from his salary an 8 percent contribution: 6½ percent for retirement pension, 1 percent for survivor's pension and ½ percent for automatic annual increase.

2. *City revenues.*—In 1975 the State statute was amended to authorize the Chicago Board of Education to demand and direct the City Council to levy a tax annually at a rate on the dollar of the value, as equalized or assessed by the Department of Local Government Affairs of all taxable property in the city, which when extended will produce an amount in 1979 and each year thereafter equal to the member contributions during the school year two years prior to the year for which the annual applicable tax is levied.

3. *State appropriation.*—Since 1951 the legislature provided that a reserve for teachers' pensions under the School Code shall be paid to the Public School Teachers' Pension and Retirement Fund of Chicago in proportion to that paid to the Illinois Teachers' Pension Fund.

4. *Investment revenue.*—At present the yield on the portfolio of the Fund is over 8 percent.

Because our revenues come from two public sources, we are now meeting the current funding problem. Our revenue pattern has undergone many changes throughout the years. For the first 12 years of existence no employer revenues were provided. In 1921, after 26 years of operation, the first tax revenue was provided. It started as a city-fixed tax rate, then a pegged levy and now a formula related to employee contributions.

The appropriation of sufficient funds to meet present costs of benefits and funds for future liabilities has received constant vigilance over the years. The Fund has current assets of over $600,000,000 and is 42.3 percent funded. Our financial strength is gradually increasing:

Assets a percentage of actuarial liabilities (funded)

	Funded
1950	15.67
1955	24.39
1960	30.81
1965	31.57
1970	31.14
1975	35.56
1978	42.30

INVESTMENT OF FUNDS

Article 17 of the Illinois Pension Code sets forth in detail the types of securities which may be purchased by the Board of Trustees. The By-laws and Rules of the Board of Trustees further define the investment policies and procedures. Up to 33⅓ per cent of the funds may be invested in stocks which are listed on the New York Stock Exchange provided the company has paid cash dividends for 5 consecutive years preceding the date of purchase.

At present we have authority but have no investments in state or local obligations because the tax-exempt feature has no attraction for the Fund.

An investment advisor is engaged for the Fund and counsels the Board on all matters pertaining to the portfolio investments. The trustees evaluate the recommendation and approve the purchase or sale of securities. The City Treasurer is custodian of the securities of the Fund and all securities are held in the Fund's name.

SECURITY

For the past 80 years the Public School Teachers' Pension and Retirement Fund of Chicago has administered the fund without problems related to benefits, vesting, payment of annuities, reporting and disclosure, violation of fiduciary responsibility or investment of funds. The pension rights of the members and their dependents are adequately protected by the City Treasury, State Department of Insurance, Constitution of the State of Illinois, the Illinois Public Employees Pension Laws Commission, and existing courts of record.

CONCLUSION

As you can see from this description, H.R. 14138 would only require the Chicago system to do what it is already doing. To audit these requirements, the bill would create a board of directors of five people paid at the executive level III compensation rate with four officers at the executive level IV and V rates, an eleven-member advisory Council on Government Plans, all to be paid at a G.S.–18 daily rate, and a new federal agency staff corps. May we suggest to the subcommittee that the Chicago teachers' plan and most other large public employee plans already have a substantial body of auditors. Please be reminded that plans such as ours could be categorized as operating "under glass" in that our auditors include not only official ones such as state attorneys, departments of insurance, auditors-general and certified public accountants . . . but also the 40,000 contributors and beneficiaries in our system, the Board of Education, and the taxpayers of Chicago and Illinois.

The Dent Report could be summarized as saying public plans have a good but not perfect record and are making substantial progress. We submit that there have been no scandalous episodes such as those that surfaced in the private sector before ERISA, again because of the public nature of our operations. Further, we hold that reporting, disclosure, or other regulation must take a low priority behind the real problem facing retirees in the United States in both the public and private sectors. That is inflation.

We know in Chicago that the constitutionally guaranteed retirement package provided to our teachers is an excellent bargain, considering the dollars we pay into the plan compared to the dollars we draw as benefits. Whether or not these benefit dollars will be rendered virtually worthless by inflation is the truly federal problem. It cannot be solved by Illinois, Chicago, and Board of Trustees, or additional reporting, disclosure, or other regulatory legislation. Our local reporting, disclosure and fiduciary responsibility are in good health. The federal dollar you provide us from Washington is not. Shouldn't we address ourselves to larger problems first?

That part of H.R. 14138 that codifies qualification for public plans is laudatory. This type of law is needed because of inconsistent IRS rulings on the taxability of benefits paid by public employee retirement systems. Most federal law regulating retirement plans was written for private plans with little consideration given to public plans. This part of the law would allow for fair and consistent federal tax treatment of public employee benefits throughout the country.

In summary, I can't say that the bill has some good and some bad, but probably more accurately, some good and some unnecessary. We need and should have the qualification section. The rest of the bill is a replication of what already exists.

Mr. WARD. My comments consist of two points. The first is simply a description of the Chicago Teachers' plan. We provided you with copies. I won't read the entire report. I will just go to our conclusions.

Essentially, our description shows that H.R. 14138 would only require us to do what we are already doing. To audit these requirements the bill would create a Board of Directors, five people, paid at the executive level III, four officers, and a new Federal agency.

We would like to suggest to the subcommittee that the Chicago Teachers' plan and most other large public employment plans already have a substantial body of auditors. Inasmuch as we are public, we operate under glass. Our auditors are not only the State attorneys, the department of insurance, the auditors general, and certified public accountants. But here in Chicago we have 40,000 contributors and beneficiaries of our system as well as the board of education and the taxpayers of Chicago and Illinois.

We see the Dent report as saying that public plans have a good but not perfect record and are making substantial progress. We suggest that there have been no scandalous episodes in the public sector as there were in the private sector before ERISA.

Furthermore we feel that reporting disclosure and other regulatory legislation should really take a back seat to the important issue confronting retirees in the United States and that is inflation. We know in Chicago that the constitutionally guaranteed retirement package provided to our teachers is an excellent bargain. We actuarially can calculate the dollars we pay in and can compare them to the dollars we draw out in benefits. Whether or not those benefit dollars will be rendered worthless by inflation is the Federal problem. It can't be solved in Illinois or Chicago, or by the board of trustees of our fund.

We submit that local reporting, disclosure and fiduciary responsibility are in good health. The Federal dollar you provide us from Washington is not. We ask whether you should be addressing yourselves to a bigger problem first.

That part of the bill that codifies qualification for public plans is laudatory. We need this type of law because of inconsistent IRS rulings as to the taxability of benefits paid by different public employee plans. This part of the law would allow for fair and consistent Federal tax treatment for all public employee benefits throughout the country.

In summary, I guess I am echoing Senator Egan. I can't say the bill has some good and some bad but some good and some unnecessary. We need and should have the qualification part. The rest of the bill is a replication of what already exists.

Thank you.

Mr. SIMON. If I could just comment, Mr. Ward, on one point that you made, as you say, you have seen no scandalous conduct to require this kind of thing. Two points mentioned this morning by our first witness, and these are two of many that have been made, to have $22 million lying idle in Alabama drawing no interest whatsoever and you now have 20 percent of the public systems that deny information about their financial status to the participants of those systems, I don't know if "scandalous" is the right word. But I think you would agree that is not desirable conduct.

Let me give you the same question I gave to Senator Egan. Will this bill impose a hardship in any way on your system?

Mr. WARD. Inasmuch as I am a taxpayer and I would have to pay the tax bill for the new Federal administration, yes. The amount of money you are going to spend to create this new Federal agency I would have to pay.

Mr. SIMON. I understand. And since I am a taxpayer I face that same burden. Assuming that it cost $200,000 to maintain the office, I don't know what your figure might be for the office, do you have any idea?

Mr. WARD. Whatever size it is, if it is not necessary it seems to me to be a lot of dollars to spend.

Mr. ERLENBORN. Mr. Chairman, might I suggest—I don't know what the figure is—that what this would create is an Employee Benefits Administration for this and ERISA. It would consolidate those activities now being duplicated by the Department of Labor and Internal Revenue Service. So what we would have is one Administration doing what is now being done at three or four different places. As a matter of fact it may be a net savings.

Mr. SIMON. But even assuming it cost another hundred or $200,000 you are talking about almost nothing.

Mr. WILKIE. What this would do for our fund in particular is a moot question. I think that is more in line with the question you are raising.

Mr. SIMON. That is really what I am interested in. If it is a hardship to your fund, then we want to modify it.

Mr. WILKIE. I don't think Mr. Ward and I have an answer for that. But I do know some of the problems we are faced with as far as our retirees are concerned. As I mentioned in my brief few remarks, we just had a bill passed this past year which went into effect in January. We are finding our retirees will receive a 1-percent increase in their pensions. Many of them are living, I might add, at somewhere at poverty level, just slightly above poverty level. So I said this was more or less just a gesture without substance as far as I am concerned.

I don't know what the administrative cost of PERISA would do for our fund. We have demands from people who leave our system. This was covered in the task force report. There are provisions in many funds that when people leave they get no interest on their money. We do not refund interest on employee contributions that are given back as refunds. I am strongly opposed to it because I feel that we represent the interest of career teachers, not passing traffic.

But yet we penalize and restrict career teachers in many areas because they are concerned to keep up with inflation. They are not keeping up with inflation. They are falling behind.

If we were to turn our fund into a savings and loan association with the in and out traffic and pay interest on money in return, obviously it would diminish any potential action we could recommend to the State for increasing benefits for those people who make teaching a career.

I feel if there is any inflationary cost involved to our fund with this type of bill, again it will be penalizing the people that the fund was designed for.

I don't have figures. I don't know. But that primarily is our big concern, just what would this do to us as far as our fund. With our fund we have had over $600 million in assets but yet we have an unfunded liability of $800 million. I certainly don't think we can afford to take this on.

Mr. Ward indicated there are staff people who comply with governmental redtape, reports, et cetera.

Mr. SIMON. The bill does not require the payment of interest.

Mr. WILKIE. I know that. But I am saying we have demands and pressures on us for things of this nature.

Mr. WARD. If I might respond to the question of whether or not it would add an extra burden to us, of course it would. We haven't missed a check in 80 years. Getting that check out each month is of paramount importance to us. We are also filing various reports with State agencies and with the Federal Government. Of course you add a 210-day deadline and you also add the penalty clause. Yes; that will be an extra burden. Certainly we have to obey the law. To the extent that we have to prepare those reports and perhaps even incur one of those penalties because we didn't make the 210 days, that would, of course, be an additional burden on us.

Other than that, without getting into the details of it, the 210 days and the other time deadlines, we are generally doing what this bill

asks us to do. We do send statements. We do send the checks. We do file all of our returns on time with the State department of insurance. We are audited by certified public accountants every year as the statute requires. We are doing all of that.

You would require us to do what we are doing. We may have some trouble fitting the various statements together. I suppose we would have to do it if you indeed passed this law.

Mr. SIMON. Mr. Erlenborn.

Mr. ERLENBORN. I don't have any questions, Mr. Chairman. I am pleased to hear the requirements of this bill are already being met by the Chicago Teachers' Pension Retirement Fund. Apparently the only burden would be that of actually completing the forms, which I would hope might be coordinated with State agencies so you can file one form both places, so long as the same information is being required. In any event it appears to be no great burden, the change in your operating procedures required by the passage of this legislation.

Mr. WARD. We had only 5 days to read the bill. We read it very quickly. I don't know if I can be any more responsive. I don't think it provides an extraordinary burden and extra paperwork. But it would be extra to whatever degree we have to meet it. The deadline, 210 days, kind of bothers me. That might give us some problems. We could be sending the same reports we are now making to you in Washington.

Mr. ERLENBORN. Let me suggest that if on further reading of this legislation after this hearing you do find any additional problems, feel free to contact either my office or the subcommittee to give us the additional information for the record.

Mr. WILKIE. Thank you.

Mr. SIMON. Thank you.

Mr. WILKIE. I think we have a challenge here in Illinois. I would like to see us meet this challenge without the Federal Government trying to solve it for us.

Thank you.

Mr. SIMON. Thank you.

Dr. Howard E. Winklevoss, Philadelphia, Pa.

[The prepared statement of Mr. Winklevoss follows:]

Statement by

Howard E. Winklevoss, President
Winklevoss & Associates, Inc.

November 15, 1978

My name is Howard E. Winklevoss. I am an associate professor of actuarial science at the Wharton School and president of Winklevoss and Associates, Inc., an actuarial consulting firm. I am a member of the Pension Research Council, an Affiliate of the American Academy of Actuaries, and an Enrolled Actuary under ERISA. I have conducted actuarial audits and related research on approximately 25 public pension plans during the past several years and have co-authored a book entitled Public Pension Plans: Standards of Design, Funding, and Reporting which will be published by Dow Jones/Irwin in January 1979.

I have reviewed the provisions of H.R. 14138 and find it difficult to argue against the basic provisions of the bill. Disclosure to plan participants, uniform reporting, and fiduciary standards are fundamental to the equitable treatment of pension plan participants in both the public and private sectors. There are two factors, however, that cause me to be reluctant in supporting the passage of the PERISA bill. The first is that most of the larger public plans substantially meet the requirements imposed by H.R. 14138. For these plans, which cover the vast majority of public employees, Federal legislation will simply place an added layer of regulation, with its concomitant costs at both the Federal and non-Federal level. My second reservation is that much of the bill's thrust will be dampened by the Federal bureaucracy created to carry out the provisions of the law as has been evidenced by the passage of ERISA. It is questionable whether the creation of the Employee Benefit Administration under PERISA will eliminate this criticism. I would prefer to see the EBA created under separate legislation and to observe its effectiveness in administering ERISA before subjecting public pension plans to Federal regulation.

I have had the distinct impression during the past few years that Federal legislators have not sought to answer the question of whether or not there should be Federal legislation of public pension plans, but, rather, have concentrated on what type of legislation to consider and

whether or not it would be constitutional. I have observed a phenomenon which has led me to conclude that the laudable objectives of H.R. 14138 can be achieved without the passage of the bill. The phenomenon has been the flurry of activity among public pension plans to upgrade themselves to ERISA-type standards since the passage of ERISA. In part, this has been caused by the greater awareness with respect to pension plans and their potential problems and shortcomings in the minds of taxpayers, plan participants, administrators, and non-Federal policymakers as a result of the passage of ERISA. Perhaps the more significant factor, however, is the threat of Federal legislation. For many public plans, this has been a strong motivator. For example, the National Conference of State Legislators has been working hard to improve public pension plans and has adopted a set of pension planning principles that will undoubtedly have a significant effect on such plans. Nearly all conference and association meetings during the past few years which involve individuals associated with public pension plans have considered at length the need to upgrade these plans to ERISA-type standards, and such deliberations are indeed having a positive impact. I feel confident that if the data collected by the Pension Task Force on public pension plans were updated, the results would show a substantial improvement in those areas that were found to be deficient and I feel that such improvements will continue.

I would like to offer for your consideration an alternative to a PERISA bill. I propose that legislation be passed that establishes the right and intention of the Federal Government to regulate public pension plans along the lines as described in H.R. 14138, but that such regulation not be imposed if, within a reasonable period of time such as 3 to 5 years, public pension plans have substantially complied with each of the provisions through state laws. This proposal would avoid the inevitable and unproductive clash between Federal and non-Federal policymakers, eliminate an added layer of Federal bureaucracy in the administration of public pension plans, allow non-Federal policymakers to add vesting,

funding, and other standards to their state laws as they deem appropriate, and--most importantly--accomplish the same ultimate goal of protecting the benefit rights of employees of public pension plans. The one drawback to this proposal is that full compliance may take an additional year or so--a seemingly small price to pay for the benefits describe above. It should be noted that Public Law 15, or the McCarran-Ferguson Act, which became law on March 9, 1945, accomplished essentially this same end with respect to the regulation of the insurance industry. In effect, Congress insisted that it was the right of the Federal Government to regulate the insurance industry, but stated in the Act that the Federal Government would not regulate insurance as long as the states did an adequate job of such regulation. This has proved a workable solution to avoiding Federal regulation, and some of the often stated disadvantages of state insurance regulation (such as one insurance company doing business in more than one state) do not apply to the area of public pension plans.

I recognize that the above recommendation will not rest well with legislators and staff members who have worked hard to formulate PERISA legislation over the past four years, as evidenced by the massive study produced by the Pension Task Force. But I would hope that this effort in an of itself would not cause you to continue to pursue Federal legislation of public pension plans--especially if there is a viable alternative.

Participation and Vesting Requirements

The data presented in the Pension Task Force Report on Public Employee Retirement Systems, as well as the experience I have had with such plans, suggests that the vast majority of public employees are in plans that meet the minimum participation requirements of ERISA. Thus, legislation would not appear to be valuable along this dimension of plan design.

With respect to vesting, employees of large public pension plans are generally afforded vesting provisions equal to, or more liberal than, the minimum requirements under ERISA. Smaller plans are frequently more restrictive. Even for plans with vesting more restrictive than ERISA minimum requirements, however, the problem is not nearly as critical as

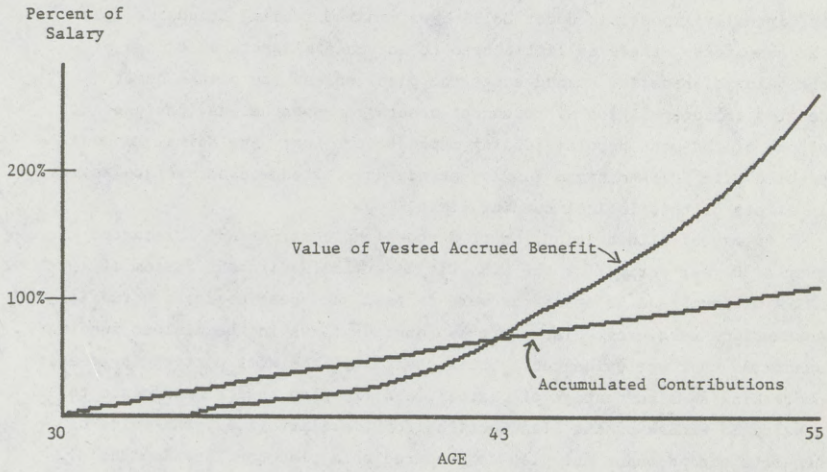
it was for private pension plans. The reason for this lies in the fact that private pension plans are predominantly non-contributory while public plans are predominantly contributory. When a public employee terminates employment his contributions are nearly always returned; and the value of such contributions are not likely to be significantly lower than the value of the benefits that would have been vested under ERISA minimum standards. This is illustrated in Chart 1, where the value of accrued benefits beyond 5 years of plan participation are compared to the value of accumulated employee contributions. In this example, the benefit formula is one providing 2% of final 5-year average salary per year of service, employee contributions are assumed to be 5½% of salary, and the interest credited on such contributions is 5%. Under these assumptions, the accumulated value of employee contributions exceeds the value of accrued benefits during the first 13 years of participation. Thus, even if full vesting were deferred until 15 years of service, the value of benefits lost to the participant terminating after 13 years and prior to 15 years of service would be minor. In fact, in situations like this, more rapid vesting may work a disservice on employees who are not aware that electing a deferred vested benefit is not in their economic best interest.

The major problem in this respect for public pension plans, however, is the fact that a large number of vested employees request a refund of their contributions at ages where the employer-provided portion of the vested benefit forfeited is substantial without knowing the full consequences of taking such a refund. Legislators at either the Federal or state level, however, must weigh the advantages of imposing an ERISA-type standard on public pension plans, which would preserve the employer-provided portion of the vested accrued benefits, against the added costs associated with such a provision. Nevertheless, at the very least, public plans should provide a participant with the types of information required under the PERISA bill and, in addition, with information on the lump-sum value of the benefits that would be forfeited if a refund of contributions were taken. The latter is not contained in the PERISA bill, and I would support

CHART 1

COMPARISON OF ACCUMULATED CONTRIBUTIONS AND VALUE OF ACCRUED BENEFIT FOR AGE 30 MALE ENTRANT

Benefit Formula = 2% of Final 5-Year Average Salary
Employee Contributions = 5½% of salary
Interest Credit on Accumulated Contributions = 5%



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such a disclosure requirement regardless of whether regulation is implemented at the Federal or state level.

Minimum Funding Requirements

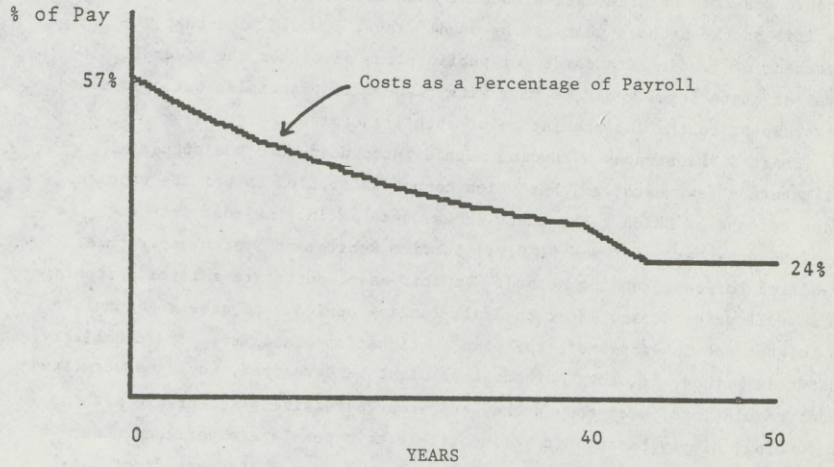
The PERISA bill does not address the subject of minimum funding requirements. Judging from the minimum funding requirements set forth in ERISA, I believe this is a valuable omission. Our research has demonstrated that ERISA minimum funding requirements would be inappropriate for public pension plans. For example, one of the principal funding objectives that a public pension plan should attempt to meet is a level-percentage-of-payroll cost pattern--a pattern which treats successive generations of taxpayers equally. This type of cost pattern is virtually impossible under ERISA-type minimum funding standards. By the same token, there is little need to accumulate assets in excess of the value of benefits earned under the plan (unless the plan sponsor desires an accumulation of redundant assets). Nevertheless, the use of one of the most popular funding methods (the Entry Age Normal Method) coupled with ERISA minimum funding standards will indeed accumulate assets in excess of this logical funding limit.

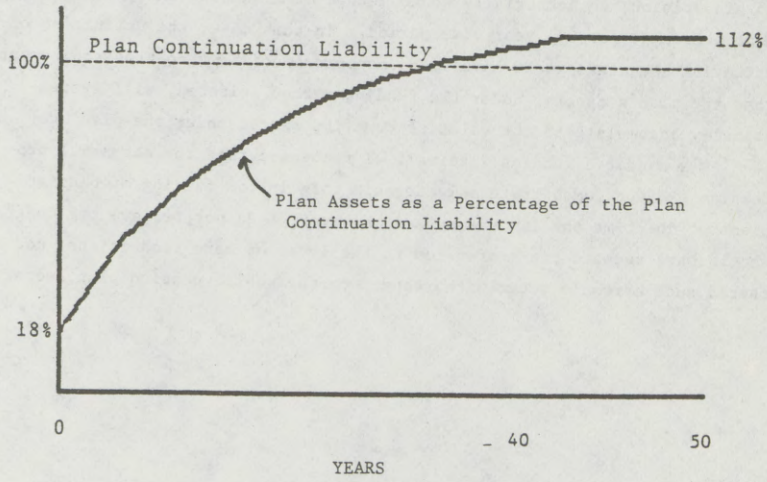
By way of illustration, Chart 2 shows the cost pattern forecasted over a 50 year period for the U.S. Civil Service Retirement System if ERISA minimum funding standards were imposed, and best-estimate actuarial assumptions were used. There are two obvious flaws in the minimum funding standards that are evidenced by this chart: (1) the cost pattern is steeply decreasing as a percentage of payroll, and (2) plan assets accumulate to a value in excess of the Plan Continuation Liability (i.e., the value of benefits earned under the plan as measured on a plan continuation basis). It should be noted that the funding method used in this example is the Entry Age Normal Method--one of the most popular funding methods used for both private and public pension plans.

One of the devastating characteristics of ERISA minimum funding requirements is the specification in the law that only certain funding methods could be used. In effect, ERISA froze the state of the art with

CHART 2

ENTRY AGE NORMAL FUNDING METHOD WITH
ERISA MINIMUM FUNDING STANDARDS



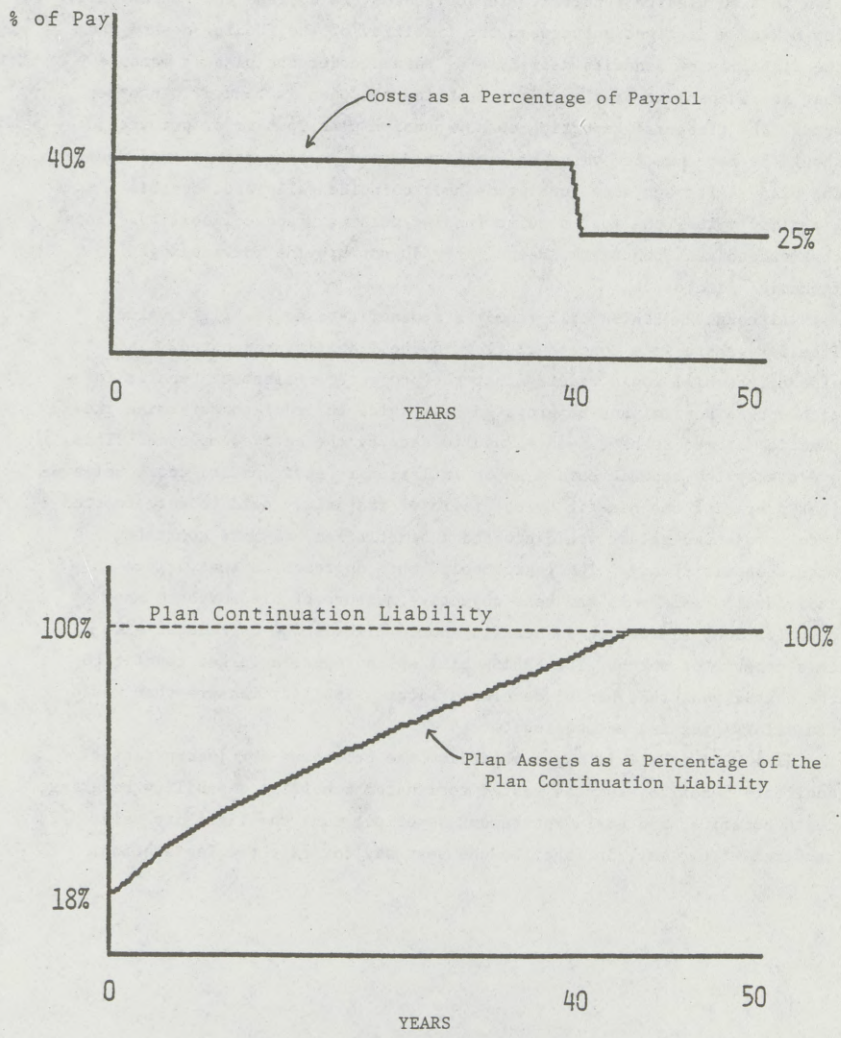


respect to pension funding for private pension plans, a problem compounded by the fact that the actuarial profession had not advanced the state of the art sufficiently by the time the law was passed. Thus, actuaries in academia and in private practice are no longer motivated to explore and conduct research on alternative funding methods because the law is overly specific on the methods that can be used. Thus, I would hope that the enactment of funding standards for public plans at either the Federal level or state level would be firm with respect to principles but open-ended with respect to the implementation of such principles.

Chart 3 illustrates a funding method introduced into the actuarial literature a few years ago, but which cannot be applied to private pension plans because of ERISA. The chart shows, once again, the cost pattern and funded pattern of the U.S. Civil Service Retirement System under this so-called Forecast Funding Method. In this case, costs are a level percentage of payroll prior to and after the full funding period, and assets accumulate up to, but not in excess of, the plan continuation liability. It is unlikely that this method, or other methods that might be developed, would be permitted under regulations, even though they represent actuarially acceptable methods of funding, simply because it is impossible to accumulate experience under the methods in order to support their use. In my view, ERISA should not have legislated, nor should a PERISA legislate at either the Federal or state level, specific funding methods. Rather, the enrolled actuary should be charged with the responsibility of certifying that the method in use is, in his opinion, an actuarially sound method of financing the pension commitment over a 40 (or 30) year time period. In this case, the definition of actuarial soundness would have to be no more specific than the requirement that the plan's assets, under the funding method selected, will systematically accumulate to the value of benefits earned under the plan over the law's mandated funding interval. I recognize that the actuarial profession did not demonstrate a leadership role in the funding of pension plans at the time the law was passed; however, I do not believe the Congress should have reduced the profession to the level of mere technicians, nor should such a result occur with respect to the public pension plan sector.

CHART 3

FORECAST FUNDING POLICY



Financial Reporting

One of the problems that plagues both private and public pension plans is the lack of standardized methodology for reporting the financial status of the plan. The error in the ERISA reporting requirements is that the liability value calculated under the funding method in use with the plan is also used to report its funded status. I applaud the PERISA bill for making a distinction between the liability of the funding method and the liability of benefits deemed to be earned under the plan--a measure that is independent of the manner in which the plan is funded. In other words, the financial reporting on any pension plan, public or private, should be based on the value of benefits deemed to have been earned under the plan. Although some funding methods coincidentally produce this liability value, the most popular funding methods produce liability values that exceed this benchmark; hence, they do not provide for meaningful financial disclosure.

Although the PERISA bill requires a benefit-based liability value, I believe there is a conceptual flaw in the liability requested. In effect, the bill would require that the projected retirement benefit for each active participant be prorated by service in order to determine the benefit deemed to have been earned to date by the active employee. This overstates the benefit earned in an inflationary environment, and I believe that prorating the benefit by the ratio of the salary paid to date to the total projected salary would produce a benefit accrual more consistent with economic theory. The logic behind this approach is that, since an individual's salary is the best objective measure of his worth to the organization, his projected benefit should likewise be correlated with this measure of worth. The PERISA bill would impute a larger benefit to the participant and, hence, develop a larger liability measure than would the salary prorated methodology.

The PERISA bill is vague regarding the procedure for incorporating ancillary benefits, such as vested terminated benefits, disability benefits, death benefits, and early retirement benefits, into the liability value required. This may, in fact, be the best way to draft the legislation;

however, I would hope that the actuarial profession would develop a consensus on how to deal with these benefits as opposed to relying on regulations to specify the procedure. There are two basic approaches for dealing with these benefits, both of which are detailed in my book, Pension Mathematics: With Numerical Illustrations; and I have no strong preference for either approach.

The PERISA bill also recognizes that, while implicit best-estimate assumptions may be acceptable for funding purposes, the same set of assumptions may not produce appropriate values for financial reporting purposes. I agree with the requirement of using explicit best-estimate assumptions for determining the financial reporting liability.

Table 1 illustrates some of the problems that exist in the financial reporting on the funded status of public pension plans. Column 1 of this table shows the unfunded liability that is currently reported on 20 public pension plans that were studied during the past two years. Column 2 shows this same liability value, but calculates it using a standard set of actuarial assumptions. The third column shows the unfunded liability calculated on standard actuarial assumptions and based on the salary prorated benefit liability. A review of these numbers serves to illustrate the importance of actuarial assumptions and methodology in the financial reporting of pension plans. The last column of Table 1 expresses the assets of the plan as a percentage of the benefit-related liability. This measure illustrates that the plans with the largest unfunded liability are not necessarily the plans with the lowest funded ratio.

Actuarial Terminology

The PERISA bill introduces three new terms: (1) annual actuarial value, (2) supplemental actuarial value, and (3) unfunded supplemental actuarial value. These represent a subset of terminology recently developed, but not widely accepted, by a group of individuals representing various professions. These terms lack intrinsic meaning and are not likely to contribute to ending the confusion about actuarial terminology. I believe the more conventional terms, (1) normal cost, (2) actuarial liability, and (3) unfunded actuarial liability, respectively, would be more appropriate.

TABLE 1

EFFECTS OF ALTERNATIVE ASSUMPTIONS AND METHODOLOGIES
ON UNFUNDED LIABILITIES OF 20 PUBLIC PENSION PLANS
(Dollars in Millions)

Plan	Reported Unfunded Liability Based on Current Assumptions and Methodology	Unfunded Liability Based on Best-Estimate Assumptions and Current Methodology		Unfunded Liability Based on Best-Estimate Assumptions and Plan Continuation Liability		Ratio of Plan Assets to Plan Continuation Liability
	(1)	Dollars (2)	(1) as % of (2)	Dollars (3)	(1) as % of (3)	
1	$111,247	$190,150	59%	$157,311	71%	18%
2	127	138	92	88	144	40
3	122	698	17	284	43	66
4	576	747	77	372	155	76
5	317	594	53	438	72	23
6	163	116	140	62	262	79
7	167	179	93	119	140	41
8	334	1,670	20	903	37	52
9	987	1,252	79	553	179	76
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11	0	743	0	632	0	0
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15	31	51	60	10	316	90
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18	106	94	113	85	125	0
19	87	77	113	71	122	0
20	0	1,162	0	818	0	0
			Ave. = 66%		Ave. = 115%	Ave. = 43%

STATEMENT OF HOWARD E. WINKLEVOSS, PRESIDENT, WINKLEVOSS & ASSOCIATES, INC., PHILADELPHIA, PA.

Mr. WINKLEVOSS. Mr. Chairman, Congressman Erlenborn, I would like first to introduce into the record a statement from Dan McGill, chairman and professor of insurance at the Wharton School who was unable to attend the hearing today because of a schedule conflict.

Mr. SIMON. That will be entered at this point.

[The statement referred to follows:]

STATEMENT OF DAN M. MCGILL

I am Dan M. McGill, Chairman and Professor of Insurance at the Wharton School of the University of Pennsylvania and Chairman of the Pension Rerearch Council of the Wharton School. I am the author of five books on pension topics, and co-author or editor of four others. I have been active in efforts to promote the soundness of pension plans in the private sector and was the first Chairman of the Advisory Committee of the Pension Benefit Guaranty Corporation, having previously written a monograph on plan termination insurance. For the last several years I have been actively engaged in research on staff retirement plans at the federal, state, and local government levels. I am a co-author (with Dr. Howard E. Winklevoss) of a book at press entitled "Public Pension Plans: Standards of Design, Funding and Reporting," prepared under a grant from the National Science Foundation. The survey of public employee retirement systems by the House Pension Task Force was a rich source of information for our NSF study.

I am making this statement in a strictly personal capacity and not on behalf of any organization with which I am affiliated. In particular, I do not purport to speak for the Pension Research Council, the members of which hold diverse views on any pension-related topic, nor in my capacity as a member of the Presidentially-appointed Advisory Committee of the PBGC. I confine my remarks to Title I of H.R. 14138. I have views on the subject matter of Title II but this is not the proper forum in which to express them, given my official connection to the PBGC.

I support the basic thrust of the Public Employee Retirement Income Security Act of 1978. State and local government public employee retirement systems constitute an important component of the nation's old-age economic security mechanism. According to best estimates, they cover about 11 million active and terminated vested participants, pay annual benefits of $9.8 billion to 2.3 million retired employees and other beneficiaries, receive annual contributions from employing agencies and employees of approximately $17.6 billion, and hold roughly $123.5 billion in assets for future benefit obligations. The true dimensions of the public pension universe are not known because at present there is no systematic procedure for gathering information about these plans; there is no requirement that relevant operating data be reported to a central agency on a regular basis and in reasonably uniform format. It is especially significant that reliable data cannot presently be gathered on the funded status of the nearly 7,000 plans in this sector. In other words, it is impossible under the present regulatory structure to determine the extent to which the accruing benefit obligations of the plans are being offset by the setting aside of assets earmarked for these obligations. Perhaps more important, in most jurisdictions there is no statutory nor administrative mandate that public pension plans be funded to any given level.

Thus, I would support H.R. 14138 as a first step toward dealing with the many troublesome problems in the public pension sector. If enacted in its present form, it would require that plan participants be informed as to the basic features of the plan and their rights thereunder and the extent to which their benefits have vested and have been funded. The plan administrator would be required to engage on behalf of all plan participants an independent qualified public accountant to examine the financial records and statements of the plan and form an opinion as to whether the financial condition of the plan is presented fairly and in conformity with generally accepted priciples applied on a consistent basis. The plan administrator must also engage on behalf of the plan participants an enrolled actuary who would be required to employ such actuarial assumptions and techniques as would be necessary to fully and fairly disclose the actuarial position of the plan. However, the emphasis is on financial and actuarial disclosure. Public sector plans would not be required by the legislation to pursue any particular funding

goal or policy. Thus, the actuarial soundness of the plans would not be assured, unless the sponsoring agency has the unquestioned fiscal capability to meet all its future obligations.

The proposed legislation would subject state and local government plans to essentially the same fiduciary standards as those imposed on private sector plans by ERISA. While there is little evidence of outright dishonesty in the management of public plan assets, the interests of the plan and its participants have often been subordinated to broaden concerns of the sponsoring agency, such as providing a market for its bonds and other financial instruments. It would be salutary for public plan administrators and other fiduciaries to be under statutory mandate to operate the plan solely in the interest of the participants and their beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying the administrative expenses of the plan. Plan asset managers would undoubtedly prefer to have their investment performance measured against the ERISA prudent man standard (proposed by H.R. 14138 for public sector plans) than against the classic common law standard. The institutional asset managers are gaining experience with the new fiduciary rules in the investment of private plan assets and could readily operate within such rules in the management of public plan funds.

In a departure from the fiduciary provisions of ERISA, the bill makes it clear that the government agency itself and not plan fiduciaries who are government employees generally will be liable to the pension plan for losses caused by imprudent fiduciary activities by such employees. While this is a source of financial security to the plan, it may not promote proper fiducial conduct by the employees, unless the employing agencies have legal recourse against the wrong doers. A more disturbing (to me) provision of the bill would relieve governors, mayors, state legislators, and other government official of any fiduciary responsibilities in connection with the setting of benefit level and the establishing of funding policies. In my opinion, some of the most irresponsible behavior in respect of public employee pension plans has been displayed by public officials in setting benefit and funding levels. I feel strongly that benefit expectations should not be created without a proper fiscal response by the sponsoring agency or agencies. There should be a fiduciary responsibility to see that a rational relationship exists between benefits and fiscal capacity. I realize that this is a sensitive area, and the nature and extent of the fiduciary responsibilities of elected officials in establishing and liberalizing pension plans would have to be carefully defined.

The bill proposes no participation, vesting, and funding standards, such as those embodied in ERISA, and it makes little, if any, attempt to reach the many abuses found in the design and administration of public employee pension plans. Presumably, the sponsors of the legislation believed that to go further would raise serious constitutional, political, and fiscal problems. Surprisingly, the proposed legislation would bestow a "qualified" status, with all the tax consequences associated with that status, to any public sector plan that meets the rather modest requirements of H.R. 14138. Clarification of the ambiguous tax status of public pension plans and their participants is a laudable objective but in granting the tax advantages qualification the federal government would be relinquishing the only inducement that it could offer public plans to comply with nondiscrimination rules and reasonably sound funding policies.

The strength of this bill is in proposing a mechanism by which the essential facts concerning the design and financing of public sector pension plans can be gathered in an orderly and recurring fashion. This would be no mean accomplishment. After the facts are known and the problems are more sharply defined, further remedial steps can be considered. The solution may lie in voluntary guidelines of the Advisory Council on Governmental Plans, as suggested by Congressman John H. Dent in introducing H.R. 14138, or of other appropriate bodies. If this approach turns out to be infeasible, compulsory standards of plan design and funding, especially the latter, may have to be imposed by the federal government or the various states. One possible approach that should be considered would be for the federal government to lay down certain statutory standards in vital areas that would apply to the extent—and only to the extent—that the states have not legislated equally rigorous standards or standards that are reasonably compatible with the federal standards.

I commend Congressmen Dent and Erlenborn and their legislative staffs for having developed this proposed legislation.

Mr. WINKLEVOSS. Thank you.

My statement is a little technical. So I would prefer to read it, if you don't mind.

Mr. SIMON. OK.

Mr. WINKLEVOSS. My name is Howard E. Winklevoss. I am an associate professor of actuarial science at the Wharton School and president of Winklevoss & Associates, Inc., an actuarial consulting firm. I am a member of the Pension Research Council, an Affiliate of the American Academy of Actuaries and an enrolled actuary under ERISA. I have conducted actuarial audits and related research on approximately 25 public pension plans during the past several years and have coauthored a book entitled "Public Pension Plans: Standards of Design, Funding and Reporting," which will be published by Dow Jones/Irwin in January 1979.

I have reviewed the provisions of H.R. 14138 and find it difficult to argue against the basic provisions of the bill. Disclosure to plan participants, uniform reporting and fiduciary standards are fundamental to the equitable treatment of pension plan participants in both the public and private sectors. There are two factors however that cause me to be reluctant in supporting the passage of the PERISA bill. The first is that most of the larger public plans substantially meet the requirements imposed by H.R. 14138. For these plans, which cover the vast majority of public employees, Federal legislation will simply place an added layer of regulation, with its concomitant costs at both the Federal and non-Federal level.

My second reservation is that much of the bill's thrust will be dampened by the Federal bureaucracy created to carry out the provisions of the law as has been evidenced by the passage of ERISA. It is questionable whether the creation of the Employee Benefit Administration under PERISA will eliminate this criticism. I would prefer to see the EBA created under separate legislation and to observe its effectiveness in administering ERISA before subjecting public pension plans to Federal regulation.

I have had the distinct impression during the past few years that Federal legislators have not sought to answer the question of whether or not there should be Federal legislation of public pension plans but rather have concentrated on what type of legislation to consider and whether or not it would be constitutional. I have observed a phenomenon which has led me to conclude that the laudable objectives of H.R. 14138 can be achieved without the passage of the bill. The phenomenon has been the flurry of activity among public pension plans to upgrade themselves to ERISA-type standards since the passage of ERISA. In part, this has been caused by the greater awareness with respect to pension plans and their potential problems and shortcomings in the minds of taxpayers, plan participants, administrators, and non-Federal policymakers as a result of the passage of ERISA. Perhaps the more significant factor however is the threat of Federal legislation. For many public plans this has been a strong motivator.

For example, the National Conference of State Legislators has been working hard to improve public pension plans and has adopted a set of pension planning principles that will undoubtedly have a significant effect on such plans. Nearly all conference and associate meetings during the past few years which involve individuals associated with public pension plans have considered at length the need to upgrade these plans to ERISA-type standards and such deliberations are indeed having a positive impact. I feel confident that if the data collected by the Pension Task Force on public pension plans were updated, the results

would show a substantial improvement in those areas that were found to be deficient and I feel that such improvements will continue.

I would like to offer for your consideration an alternative to a PERISA bill. I propose that legislation be passed that establishes the right and intention of the Federal Government to regulate public pension plans along the lines as described in H.R. 14138, but that such regulation not be imposed if, within a reasonable period of time such as 3 to 5 years, public pension plans have substantially complied with each of the provisions through State laws. This proposal would avoid the inevitable and unproductive clash between Federal and non-Federal policymakers, eliminate an added layer of Federal bureaucracy in the administration of public pension plans, allow non-Federal policymakers to add vesting, funding, and other standards to their State laws as they deem appropriate and, most importantly, accomplish the same ultimate goal of protecting the benefit rights of employees of public pension plans.

The one drawback to this proposal is that full compliance may take an additional year or so, a seemingly small price to pay for the benefits described above. It should be noted that Public Law 15 or the McCarran-Ferguson Act, which became law on March 9, 1945 accomplished essentially this same end with respect to the regulation of the insurance industry. In effect, Congress insisted that it was the right of the Federal Government to regulate the insurance industry but stated in the act that the Federal Government would not regulate insurance as long as the States did an adequate job of such regulation. This has proved a workable solution to avoiding Federal regulation and some of the often stated disadvantages of State insurance regulation, such as one insurance company doing business in more than one State, do not apply to the area of public pension plans.

I recognize that the above recommendation will not rest well with legislators and staff members who have worked hard to formulate PERISA legislation over the past 4 years, as evidenced by the massive study produced by the Pension Task Force. But I would hope that this effort in and of itself would not cause you to continue to pursue Federal legislation of public pension plans, especially if there is a viable alternative.

The data presented in the "Pension Task Force Report on Public Employee Retirement Systems," as well as the experience I have had with such plans, suggests that the vast majority of public employees are in plans that meet the minimum participation requirements of ERISA. Thus, legislation would not appear to be valuable along this dimension of plan design.

With respect to vesting, employees of large public pension plans are generally afforded vesting provisions equal to or more liberal than the minimum requirements under ERISA. Smaller plans are frequently more restrictive. Even for plans with vesting more restrictive than ERISA minimum requirements, however, the problem is not nearly as critical as it was for private pension plans. The reason for this lies in the fact that private pension plans are predominantly noncontributory while public plans are predominantly contributory. When a public employee terminates employment, his contributions are not likely to be significantly lower than the value of the benefits that would have been vested under ERISA minimum standards. This is illustrated in chart 1, where the value of accrued benefits beyond 5 years of plan

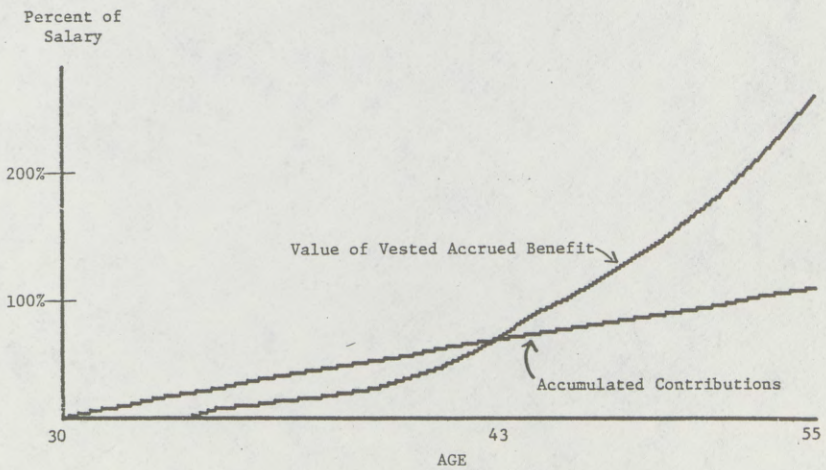
participation are compared to the value of accumulated employee contributions. In this example the benefit formula is one providing 2 percent of final 5-year average salary per year of service, employee contributions are assumed to be 5½ percent of salary, and the interest credited on such contributions is 5 percent. Under these assumptions, the accumuluated value of employee contributions exceeds the value of accrued benefits during the first 13 years of participation. Thus, even if full vesting were deferred until 15 years of service, the value of benefits lost to the participant terminating after 13 years and prior to 15 years of service would be minor. In fact, in situations like this, more rapid vesting may work a disservice on employees who are not aware that electing a deferred vested benefit is not in their economic best interest.

The major problem in this respect for public pension plans, however, is the fact that a large number of vested employees request a refund of their contributions at ages where the employer-provided portion of the vested benefit forfeited is substantial, without knowing the full consequences of taking such a refund. Legislators at either the Federal or State level, however, must weigh the advantages of imposing an ERISA-type standard on public pension plans, which would preserve the employer-provided portion of the vested accrued benefits, against the added costs associated with such a provision. Nevertheless, at the very least, public plans should provide a participant with the types of information required under the PERISA bill and in addition with information on the lump-sum value of the benefits that would be forfeited if a refund of contributions were taken. The latter is not contained in the PERISA bill, and I would support such a disclosure requirement regardless of whether regulation is implemented at the Federal or State level.

CHART 1

COMPARISON OF ACCUMULATED CONTRIBUTIONS AND VALUE OF ACCRUED BENEFIT FOR AGE 30 MALE ENTRANT

Benefit Formula = 2% of Final 5-Year Average Salary
Employee Contributions = 5½% of salary
Interest Credit on Accumulated Contributions = 5%

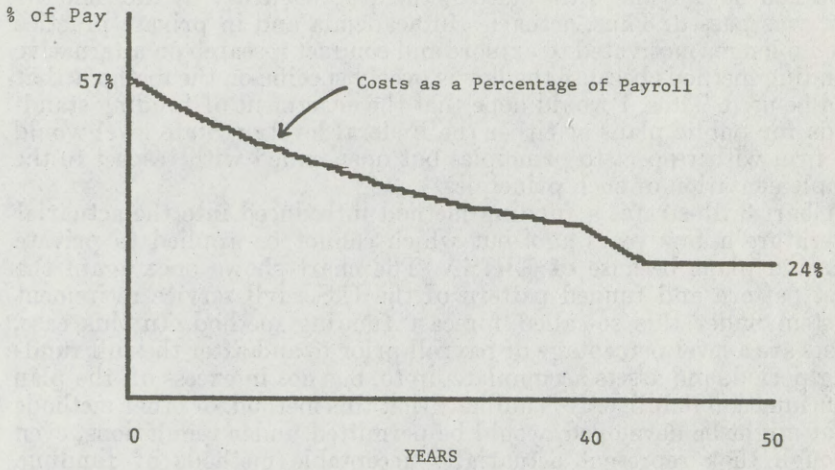


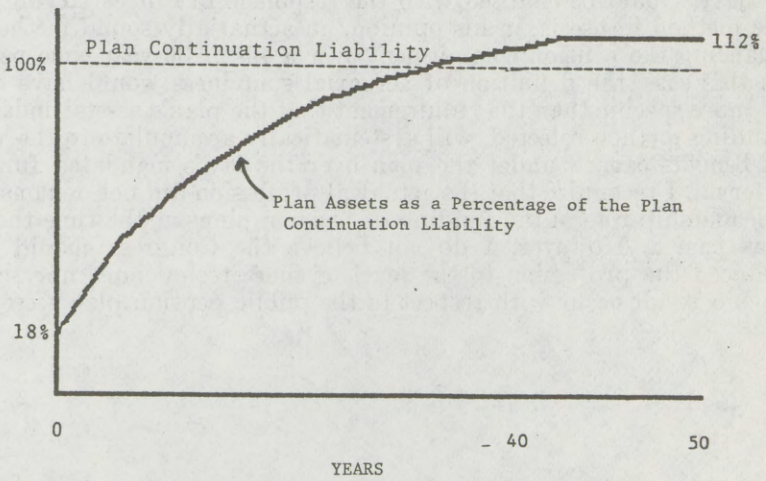
Mr. WINKLEVOSS. The PERISA bill does not address the subject of minimum funding requirements. Judging from the minimum funding requirements set forth in ERISA, I believe this is a valuable omission. Our research has demonstrated that ERISA minimum funding requirements would be inappropriate for public pension plans. For example, one of the principal funding objectives that a public pension plan should attempt to meet is a level-percentage-of-payroll cost pattern, a pattern which treats successive generations of taxpayers equally. This type of cost pattern is virtually impossible under ERISA-type minimum funding standards. By the same token, there is little need to accumulate assets in excess of the value of benefits earned under the plan, unless the plan sponsor desires an accumulation of redundant assets. Nevertheless, the use of one of the most popular funding methods, the entry age normal method, coupled with ERISA minimum funding standards, will indeed accumulate assets in excess of this logical funding limit.

By way of illustration, chart 2 shows the cost pattern forecasted over a 50-year period for the U.S. civil service retirement system if ERISA minimum funding standards were imposed, and best-estimate actuarial assumptions were used. There are two obvious flaws in the minimum funding standards that are evidenced by this chart: One, the cost pattern is steeply decreasing as a percentage of payroll; and two, plan assets accumulate to a value in excess of the plan continuation liability; that is, the value of benefits earned under the plan as measured on a plan continuation basis. It should be noted that the funding method used in this example is the entry age normal method, one of the most popular funding methods used for both private and public pension plans.

CHART 2

ENTRY AGE NORMAL FUNDING METHOD WITH
ERISA MINIMUM FUNDING STANDARDS



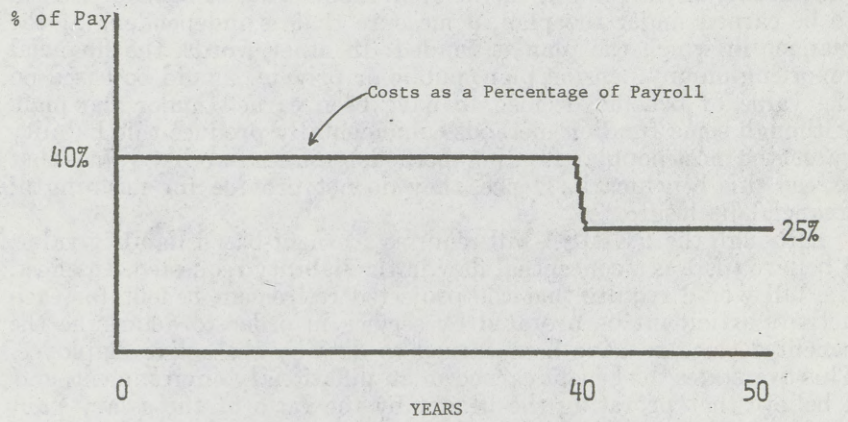


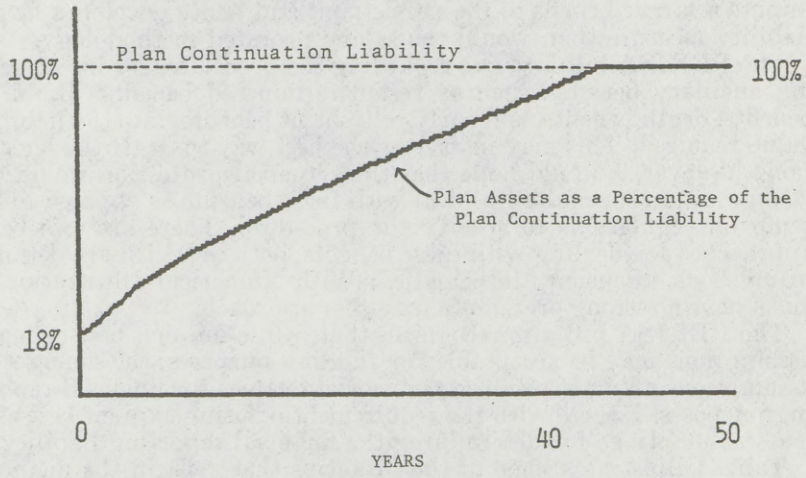
Mr. WINKLEVOSS. One of the devastating characteristics of ERISA minimum funding requirements is the specification in the law that only certain funding methods could be used. In effect, ERISA froze the state of the art with respect to pension funding for private pension plans, a problem compounded by the fact that the actuarial profession had not advanced the state of the art sufficiently by the time the law was passed. Thus, actuaries in academia and in private practice are no longer motivated to explore and conduct research on alternative funding methods because the law is overly specific on the methods that can be used. Thus, I would hope that the enactment of funding standards for public plans at either the Federal level or State level would be firm with respect to principles but open-ended with respect to the implementation of such principles.

Chart 3 illustrates a funding method introduced into the actuarial literature a few years ago, but which cannot be applied to private pension plans because of ERISA. The chart shows once again the cost pattern and funded pattern of the U.S. civil service retirement system under this so-called forecast funding method. In this case, costs are a level percentage of payroll prior to and after the full funding period, and assets accumulate up to, but not in excess of, the plan continuation liability. It is unlikely that this method, or other methods that might be developed, would be permitted under regulations, even though they represent actuarially acceptable methods of funding, simply because it is impossible to accumulate experience under the methods in order to support their use. In my view, ERISA should not have legislated nor should a PERISA legislate at either the Federal or State level specific funding methods. Rather, the enrolled actuary should be charged with the responsibility of certifying that the method in use is, in his opinion, an actuarially sound method of financing the pension commitment over a 40- or 30-year time period. In this case, the definition of actuarial soundness would have to be no more specific than the requirement that the plan's assets, under the funding method selected, will systematically accumulate to the value of benefits earned under the plan over the law's mandated funding interval. I recognize that the actuarial profession did not demonstrate a leadership role in the funding of pension plans at the time the law was passed. However, I do not believe the Congress should have reduced the profession to the level of mere technicians, nor should such a result occur with respect to the public pension plan sector.

CHART 3

FORECAST FUNDING POLICY





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Mr. WINKLEVOSS. One of the problems that plagues both private and public pension plans is the lack of standardized methodology for reporting the financial status of the plan. The error in the ERISA reporting requirements is that the liability value calculated under the funding method in use with the plan is also used to report its funded status. I applaud the PERISA bill for making a distinction between the liability of the funding method and the liability of benefits deemed to be earned under the plan, a measure that is independent of the manner in which the plan is funded. In other words, the financial reporting on any pension plan, public or private, should be based on the value of benefits deemed to have been earned under the plan. Although some funding methods coincidentally produce this liability value, the most popular funding methods produce liability values that exceed this benchmark. Hence, they do not provide for meaningful financial disclosure.

Although the PERISA bill requires a benefit-based liability value, I believe there is a conceptual flaw in the liability requested. In effect, the bill would require that the projected retirement benefit for each active participant be prorated by service in order to determine the benefit deemed to have been earned to date by the active employee. This overstates the benefit earned in an inflationary environment, and I believe that prorating the benefit by the ratio of the salary paid to date to the total projected salary would produce a benefit accrual more consistent with economic theory. The logic behind this approach is that, since an individual's salary is the best objective measure of his worth to the organization, his projected benefit should likewise be correlated with this measure of worth. The PERISA bill would impute a larger benefit to the participant and hence develop a larger liability measure than would the salary prorated methodology.

The PERISA bill is vague regarding the procedure for incorporating ancillary benefits, such as vested terminated benefits, disability benefits, death benefits, and early retirement benefits, into the liability value required. This may in fact be the best way to draft the legislation; however, I would hope that the actuarial profession would develop a concensus on how to deal with these benefits as opposed to relying on regulations to specify the procedure. There are two basic approaches for dealing with these benefits, both of which are detailed in my book "Pension Mathematics: With Numerical Illustrations"; and I have no strong preference for either approach.

The PERISA bill also recognizes that, while implicit best-estimate assumptions may be acceptable for funding purposes, the same set of assumptions may not produce appropriate values for financial reporting purposes. I agree with the requirement of using explicit best-estimate assumptions for determining the financial reporting liability.

Table 1 illustrates some of the problems that exist in the financial reporting on the funded status of public pension plans. Column 1 of this table shows the unfunded liability that is currently reported on 20 public pension plans that were studied during the past 2 years. Column 2 shows this same liability value but calculates it using a standard set of actuarial assumptions. The third column shows the unfunded liability calculated on standard actuarial assumptions and based on the salary prorated benefit liability. A review of these num-

bers serves to illustrate the importance of actuarial assumptions and methodology in the financial reporting of pension plans. The last column of table 1 expresses the assets of the plan as a percentage of the benefit-related liability. This measure illustrates that the plans with the largest unfunded liability are not necessarily the plans with the lowest funded ratio.

TABLE 1.—EFFECTS OF ALTERNATIVE ASSUMPTIONS AND METHODOLOGIES ON UNFUNDED LIABILITIES OF 20 PUBLIC PENSION PLANS

[Dollar amounts in millions]

Plan	Reported unfunded liability based on current assumptions and methodology	Unfunded liability based on best-estimate assumptions and current methodology		Unfunded liability based on best-estimate assumptions and plan continuation liability		Ratio of plan assets to plan continuation liability (percent)
		Amount	Col. 1 as percent of col. 2	Amount	Col. 1 as percent of col. 4	
	(1)	(2)	(3)	(4)	(5)	(6)
1	$111,247	$190,150	59	$157,311	71	18
2	127	138	92	88	144	40
3	122	698	17	284	43	66
4	576	747	77	372	155	76
5	317	594	53	438	72	23
6	163	116	140	62	262	79
7	167	179	93	119	140	41
8	334	1,670	20	903	37	52
9	987	1,252	79	553	179	76
10	864	712	121	555	156	47
11	0	743	0	632	0	0
12	18	19	95	10	184	53
13	15	48	32	22	70	68
14	103	433	24	178	58	80
15	31	51	60	10	316	90
16	106	152	70	121	88	26
17	210	341	62	250	84	26
18	106	94	113	85	125	0
19	87	77	113	71	122	0
20	0	1,162	0	818	0	0
Average			66		115	43

Mr. WINKLEVOSS. The PERISA bill introduces three new terms: One, annual actuarial value; two, supplemental actuarial value; and three, unfunded supplemental actuarial value. These represent a subset of terminology recently developed, but not widely accepted, by a group of individuals representing various professions. These terms lack intrinsic meaning and are not likely to contribute to ending the confusion about actuarial terminology. I believe the more conventional terms—one, normal cost; two, actuarial liability; and three, unfunded actuarial liability, respectively—would be more appropriate.

Thank you very much.

Mr. SIMON. Thank you very much for your testimony. You offer one very intriguing suggestion. It is intriguing to me. That is where you suggest that the Federal Government simply establish criteria, and if the States meet that within a certain period of time, say, 3 to 5 years, then there would not be any Federal intervention in those States.

Have you discussed this idea with others? Does this have some general appeal, do you think?

Mr. WINKLEVOSS. It just occurred to me as I was writing this over the weekend. I did have an opportunity to discuss it with my col-

league, Dr. McGill. He mentioned the same point in the statement. But I have not heard——

Mr. SIMON. It is a brand new idea. You haven't discussed it with too many people then.

I feel like tossing a question to my colleague from Illinois.

Mr. ERLENBORN. Go ahead.

Mr. SIMON. What is your reaction to the suggestion?

Mr. ERLENBORN. It is an intriguing idea. It has, I will say very frankly, bothered me considerably, the necessity of Federal legislation in an area that is basically under the jurisdiction of State and local government. As a constitutional conservative I am rather slow to move into an area like this. I have been persuaded that there has been a real lack of attention however to public pension plan problems at the State and local level. I felt that Federal intrusion was warranted because of that.

If it is possible to accomplish the result without direct Federal intrusion, I think that would be the best of both worlds.

Mr. SIMON. And you would have the States report to what agency?

Mr. WINKLEVOSS. If the EBA were set up, that would be the agency they would report to. I might add that one of the things I didn't put in my statement is that a lot of States, which have consolidated pension systems and where there may be only several major systems operating, do not have too many problems. They could easily upgrade themselves, and the reporting requirements wouldn't be onerous, I don't believe.

The real problem rests with little small plans, Pennsylvania being perhaps the worst case. I would strongly favor some sort of an incentive, so to speak, that would consolidate small plans into the larger plans. It would eliminate a lot of duplication of investment work and reporting work. It would be more efficient with respect to the administration of the system. I haven't come across any creative ideas on how you would effectuate that, but I believe in consolidation of smaller plans into larger plans.

The Federal requirement I am suggesting is that we will regulate if you don't demonstrate to us through your State laws that you have in fact regulated at least at these levels, and further. I think that would solve most all of the problems.

Mr. SIMON. I don't argue with your theory about consolidation. I don't know that the Federal Government needs to get into that. But by requiring meeting certain standards in effect many States would have forced into consideration that very thing.

Mr. WINKLEVOSS. Exactly. If Pennsylvania had to demonstrate to you folks that the plans in their State are substantially complying with this and other standards, I think one of the prime agenda items should be the consolidation of those plans.

Mr. SIMON. Mr. Erlenborn.

Mr. ERLENBORN. I want to thank you very much for your testimony. I think in particular the latter part of it will be grist for the mill of our professional actuary on the staff here. Most of us are not going to understand it all that well. We will wait for his comments on that when we get back to Washington.

You made one observation about the public plans and their generally meeting certain standards, participation, vesting and so forth and

commented about the general provision of public plans for return of contribution when terminating if not vested.

Let me ask you if you have much experience with the fire and police pension plans. They seem to vary quite generally from the norm.

Mr. WINKLEVOSS. I have not had experience generally. I have studied three or four police and fire pension plans. This is one problem I would like to mention. When you talk about public pension plans it is very difficult to generalize. We are all guilty of the same thing. It is very difficult to generalize because there are the large plans which are an entity into themselves and there are the police and fire plans, which are another completely different world. Then, there are the small plans, which are also completely different.

One of the things that I think—and I want to commend the Pension Task Force for the really wonderful work on the report that they produced—is that it may be too good. There may be too much information in there. I would like to see or suggest that maybe some of those tables be condensed and some of the big plans be segregated out. They are segregated, but the definition of large plans is 1,000 or more people. I would define a large plan to be maybe 5,000 or 10,000 or more. Maybe take another look at that because, when you look at one result with respect to the number of plans and then the same answer with respect then to the number of participants, it is exactly opposite in every case almost. So I think a lot of the problems are with the small plans.

Mr. ERLENBORN. I can't talk in generalities either. But it is not at all uncommon for fire and police plans to have, say, 20 years as a vesting standard, maybe even a contributory plan and no refund of contributions if one terminates before vesting.

Mr. WINKLEVOSS. I was shocked to learn that from the Pension Task Force study.

Mr. ERLENBORN. The strange thing is you don't seem to hear too many complaints from firemen, policemen, that are participating in plans like that. It seems to me they are being treated altogether differently from most public employees who have portability provisions, able to move from one public employment to another or have the refund provisions, which is quite common outside of the fire and police plans.

Mr. WINKLEVOSS. It is possible that perhaps their leaders find it embarrassing to quibble about some of these provisions when the plans themselves are often very generous with respect to benefits and retirement age.

Mr. ERLENBORN. You can get into that whole question of disability retirement and the experience of Washington, D.C., where one year 98 percent of the policemen and firemen retired with disability, consistently around 80 percent. That is another area, not the subject of these hearings but another whole area of abuse of pension plans at the State and local level.

Again, thank you very much. It is good to see you again. Maybe some of the people are not aware that you really have kind of been on the ground floor of the Pension Task Force efforts in our Education and Labor Committee efforts on ERISA, having conducted the study on the cost of vesting.

Mr. WINKLEVOSS. Yes, I did quite a bit of research on the cost of vesting. I wish now I had done more or had been asked to or even on

my own volition done more on the funding requirements because I do see in retrospect some problems there.

I would also like to mention if I may, I know it is a convenient excuse to postpone legislation by saying that there should be studies done and that sort of thing. I don't mean to fall into that rut. But I was a little dismayed to find that there were a few small projects like the one I engaged on prior to ERISA and then subsequent to that bill's passage maybe two years after it, I believe the Department of Labor let some $3 million worth of research contracts to see if what was done was correct.

I would hope that that scenario would be reversed and that in the public pension plan sector that the Congress feels very comfortable with the facts prior to legislation. If some of the studies that are being done in the private sector would be done prior to the law in the public sector, I think it might be a better way to consider the legislation.

Mr. ERLENBORN. I appreciate that comment. I think you would agree it is probably wise in this area if we not even consider at this time participation, vesting, funding, some of the more critical issues. Reporting, disclosure and fiduciary standards are areas we are addressing in the proposed legislation. I think they have been pretty well documented as to the need. We will in my opinion make no effort to move in to the other areas until there are studies. Thank you very much.

The next witness is Dr. Elsie Watters, director of research, Tax Foundation, Inc.

STATEMENT OF ELSIE M. WATTERS, DIRECTOR OF RESEARCH, TAX FOUNDATION, INC.

Ms. WATTERS. Congressman, I would like to read my statement. I am Elsie Watters, director of research of the Tax Foundation. The Tax Foundation is a publicly supported, nonprofit organization founded in 1937 to engage in nonpartisan research and public education on the fiscal and management aspects of government. Our objective is perhaps best characterized by our motto: "Toward Better Government Through Citizen Understanding."

We appreciate your invitation to appear here today and to give our reactions to the proposals in H.R. 14138.

Over the years our research has included studies of State and local employee pension systems. The most recent of these was completed in 1976. My comments today stem largely from information which was brought to light in the course of that study.

The most serious problem facing State and local employee pension systems, we believe, derives from the fact that many of these jurisdictions have promised and continue to promise future pension benefits far beyond the amount of resources they are willing or able to set aside to meet them. There is discouraging evidence that many of the systems are out of control, on a runaway course which could in the years ahead force choices between bankruptcy and unrealistic increases in tax burdens.

While H.R. 14138 does not address the funding problem directly—and we feel strongly that it should not—it does do so indirectly by the

requirement that participating employees and the taxpaying public have financial information about the pension systems.

Clearly we have come a long way from the view of pensions expressed as recently as 1957 when one court ruled that pensions are "in the nature of a bounty springing from the appreciation and graciousness of the sovereign." Pensions are now seen as a fundamental part of any employment package. If States and localities are to obtain high-caliber employees, their pension plans must be combined efficiently into the total package of benefits, and that package must be competitive with compensation offered elsewhere.

Since retirement benefits are an integral part of the compensation package, every employee has a right to know the details of his benefits when he accepts a job and also when changes are made in the plan. He should also have the right of assurance that funds set aside on his behalf—by himself and his employer—are properly managed so as not to jeopardize his right to receive the full benefits he has been promised upon retirement.

At the same time the rights of taxpayers should be recognized. Currently State and local taxes provide about $15 billion annually to State and local employee retirement systems. This represents almost half of the entire revenues of the systems. By and large the taxpaying public in most jurisdictions is quite poorly informed as to the financing of the pension systems. They are unlikely to know whether current financing arrangements are adequate to insure that employees will receive the benefits to which they are entitled or whether, by allowing pension system liabilities to rise by more than the resources to meet them, the jurisdiction is incurring hidden debt which will be passed on to future generations of taxpayers.

The Tax Foundation has found that State and local officials who determine the provisions of employee pension systems often lack sufficient knowledge of the inner workings of the system to enact sound legislation. Each year hundreds of pension bills flood the State legislatures. Where many such proposals must be considered, governing bodies often do not have enough knowledge of the potential implications of the measures to make wise decisions. In a survey of over two dozen States we found that the major threat to the financial solvency of most systems was held to be not in the commitments already made to future retirees but in the endless stream of employee proposals to gain still higher benefits.

We at the Tax Foundation believe that the requirements for openness in reporting and disclosure provisions of public employee pension systems as contained in H.R. 14138 would open the door to greater awareness by employees, taxpayers, and legislators of potential problems in these systems. Such awareness can do a great deal to avoid problems resulting from inadequate current funding of future pension benefits.

The proposed reporting system would make the current sources and amounts of financing a matter of public record. As H.R. 14138 recognizes, however, the adequacy of funding is not a matter that either employees or the public generally can determine by off-hand judgments based on current financial statements. There is need for experienced

actuaries to render such judgments. And because there are invariably elements of human judgment in actuarial evaluations even under the most objective standards, there should be public knowledge of the key assumptions used in arriving at the actuarial results, including future interest rates, employment growth, average future earnings, prospective inflation, and longevity rates.

In the field of fiduciary responsibilities, many examples of specific abuses have been reported. In some cases there has been substantial diversion of pension funds to purposes outside the scope of the interest of the system's members. Pension contributors in at least a few instances have been used as general operating revenues. Elected officials have at times sought to gain personal or political advantages, even at the expense of the employee pension funds with which they are entrusted. Questionable loans and investments have been made.

In particular there should be careful public scrutiny of purchases by public pension funds of securities issued by their own States and local governments. This seems to be a major area of possible conflict of interest. For one thing, tax-exempt bond yields are generally lower than those of corporate issues of comparable quality and there should be no reason for public pension funds to choose them for investment. In some instances such transactions seem to be an attempt at "coverup" for a jurisdiction's near bankrupt status on operating accounts. Moreover, the bargaining position of employees and beneficiaries vis-a-vis Government employers could be measurably altered, to the detriment of the taxpaying public and the services they would ordinarily have the right to receive in return for their tax dollars. While any specified limit on the amounts pension funds can invest in securities of their own employing units may be a somewhat arbitrary figure, such as the 10 percent included in H.R. 14138, clearly some limitation seems prudent. I have no basis for questioning the 10-percent limit.

We note that this measure would establish an advisory council on governmental plans which among other things would establish guidelines for such provisions as vesting and funding. Any attempt on the part of the Federal Government at this time to mandate standards of this nature would seem to us most inappropriate. While many of the larger State and local systems would be little affected, if at all, the effects could be catastrophic for some units. Moreover, the Federal Government scarcely seems in a position to mandate funding standards for State and local systems, in view of the deficiencies in many of its own retirement systems.

We believe that the States and localities on their own are making substantial progress in the area of pension funding and management. Well over half the members are enrolled in large State general systems, often covering hundreds of local contracting groups. These large systems, which are growing far more rapidly than others, generally appear to have responsible funding arrangements. This trend toward consolidation of numerous small systems, each loosely controlled, tends to mitigate many problems, such as the kind of leapfrogging actions involved when a great many small plans constantly compete to obtain more favorable benefits. There are also advantages from the standpoint of administration of the systems, managing assets and other areas.

Further, governments in the aggregate are clearly putting forth greater efforts to meet growing pension costs. In recent years annual Government contributions to the funds have risen at the rate of 17 percent annually as compared to an increase of about 10 percent in expenditures for other purposes. In some cases, court actions have been responsible for these funding improvements but most have been voluntary. These and other moves to exert controls over future costs show a growing awareness of the need for proper funding of pension costs on the part of State and local authorities.

Many State and local jurisdictions will not welcome the additional regulations and controls, paperwork burdens et cetera imposed upon them by this measure. This is especially true when State and local officials, as well as those in the private sector, already feel that regulatory burdens are too costly and in some cases unnecessary. We would therefore urge that strong effort be made to keep the additional reporting and accounting requirements as simple as possible, consistent with the goals of the legislation. New requirements on reporting for many of the smaller jurisdictions in particular could have serious consequences in adding costs to pension systems which are already in poor financial condition. It might be desirable to temper the rules for some of these systems by outright exemption from the law or provision for a grace period of some years during which they would have the opportunity to merge with a larger system.

Finally, in criticism of this measure, I am tempted to raise a question as to whether the Federal Government should attempt at this time to enter the field of State and local retirement systems when it has apparently performed rather poorly in administering the law as approved in 1974 for private systems. However, in view of recent legislation extending some controls to the Federal systems, there is probably no compelling reason for excluding the remaining public systems. Moreover, we believe that the previous administrative problems would be mitigated, under provisions of H.R. 14138, by the establishment of a single agency to enforce the law for all public and private systems. This would remove the dual and conflicting jurisdiction of the Treasury and the Department of Labor.

Thank you.

Mr. SIMON. Thank you very much, Dr. Watters. I believe you were present and heard Dr. Winklevoss' suggestion.

Ms. WATTERS. I did.

Mr. SIMON. What was your reaction to that?

Ms. WATTERS. You mean——

Mr. SIMON. His suggestion on establishing certain criteria that the States would have 3 to 5 years——

Ms. WATTERS. Something of that sort was running through my mind. I didn't have a particular proposal. But I think that would certainly be reasonable. I think you have said and others have said many of the systems won't be affected seriously by these requirements. But some of them would be. And I think a grace period or warning, something of that sort, would certainly be effective.

Mr. SIMON. Your testimony quotes a figure I had not seen before, this figure of 17 percent growth in contributions.

Ms. WATTERS. Yes. The governments are picking up the bills.

Mr. SIMON. Yes.

Mr. Erlenborn?

Mr. ERLENBORN. Thank you, Mr. Chairman.

Dr. Watters, let me thank you for your testimony. It is quite supportive of our efforts.

Ms. WATTERS. Thank you.

Mr. ERLENBORN. You point out some defects in the present ERISA legislation. I couldn't agree with you more wholeheartedly. I particularly welcome your support of the concept of creating an Employee Benefits Administration, a consolidated administration of the present ERISA law and the proposed PERISA.

So just generally I want to say thank you very much. Your testimony is excellent because I agree with every word of it.

Ms. WATTERS. Thank you very much.

Mr. ERLENBORN. Thank you.

Mr. SIMON. Next, Mr. Jack Hawkonsen, first vice president, International Conference of Police Associations.

Thank you for being here. We welcome your testimony.

[The prepared statement of Mr. Hawkonsen follows:]

STATEMENT OF JACK R. HAWKONSEN, 1ST VICE PRESIDENT, INTERNATIONAL CONFERENCE OF POLICE ASSOCIATIONS

Mr. Chairman, and members of the Subcommittee, I am Jack Hawkonsen, 1st Vice President of the International Conference of Police Associations, and President of the Confederation of Police in Chicago. The International Conference represents over 200,000 police officers throughout the United States.

We wish to thank you for this opportunity to testify on H.R. 14138—Public Employee Retirement Income Security Act of 1978. We realize that this bill was introduced in order to obtain input from associations such as ours so that the material received can be evaluated by the Congress in its study of the entire public pension system.

We are in support of the guidelines proposed, and agree that there should be reporting procedures adopted, preferably to the participating members so that they are aware of the benefits available and the financial posture of their fund. In many cases, members are unaware of the availability of benefits, and while we can assume part of the responsibility as union representatives to make this information available, it is also the responsibility of the state or city agency to provide this service.

Because of legislative actions, many changes take place each year, and this reporting function becomes a necessary part of the responsibility to the participating members. We would also advocate the actuarial funding of existing pension plans so that the members can be assured of the availability of funds to meet the liabilities of the program.

There are approximately 450,000 police officers throughout the United States, most of whom are members of some form of public employee retirement system. The benefit of each of these systems vary tremendously, and in most cases, the amount of contribution on the part of the participating employee is different.

We in the I.C.P.A., have advocated separate retirement systems for police and firemen because of the different elements involved in our jobs, which make it impossible to lump us into one all-encompassing public employee pension system. The dangers of our employment, the constant changing of our tours of duty, complexities of our relationship, not only with our employers who act as disciplinarians, but to the public at large, and the obvious necessity to provide our families with some compensating benefits such as can only be achieved by better and more liberal pensions make it impossible to establish an equitable system as part of the general public employee system.

We would strongly oppose any legislation which would attempt to consolidate us into a general structure and, in all probability, lessen the benefit many of our members currently enjoy. We feel that many of these benefits were obtained at the bargaining table during negotiations and were the result of trade-offs

because of the lack of funds for other economic demands. To give up any of these current benefits would be a destruction of our whole collective bargaining structure (limited as it is already for police and firemen).

One area we are interested in is the availability of early vesting in those funds where it is not a reality today. There are some cases of 15-year vesting, such as in New York, but these are rare and we would be inclined to look with favor on any provision that would establish a 10-year vesting. Because of the dangerous nature of our work, many officers feel that they are not capable, or desirous of staying in police service, but because of the lack of vesting are reluctant to leave. They feel that after serving 10 or more years, they are sacrificing too much of their careers just to walk away without any tangible reward for those years. I am sure that a vesting program could be worked out that would be able to accommodate the differences in retirement age currently in practice in existing plans.

In the area of portability, we believe that it could become a benefit provided that it did not also involve itself with lateral entry. As you may be aware, the I.C.P.A., which represents the rank and file police officer, has strong reservations about lateral entry. We feel that police administrators could effectively use lateral entry as a means of destroying the incentive for advancement in many of our smaller departments, when such advancement does not occur as frequently as it does in larger departments. We would be interested in studying portability at the entrance level and in hardship and medical cases, but would have to oppose its application in conjunction with lateral entry.

We cannot agree with any plan that would tie Social Security benefits into pension benefits. In police systems, the pension benefit has either been negotiated or legislated as an employee benefit and should not be reduced or limited upon the attainment of coverage under Social Security. In many cities, officials have attempted to use the cost of Social Security as a wedge to reduce pension benefits, and as I stated before, this would be the complete destruction of collective bargaining as it now exists.

We will continue to work with this committee in an effort to provide the necessary safeguards to protect our pension fund, but will also continue to reserve the right to oppose any proposal that would reduce current benefits.

Thank you.

STATEMENT OF JACK R. HAWKONSEN, FIRST VICE PRESIDENT, INTERNATIONAL CONFERENCE OF POLICE ASSOCIATIONS

Mr. HAWKONSEN. Mr. Chairman, and members of the subcommittee, I am Jack Hawkonsen, first vice president of the International Conference of Police Associations and president of the Confederation of Police in Chicago. The international conference represents over 200,000 police officers throughout the United States.

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One area we are interested in is the availability of early vesting in those funds where it is not a reality today. There are some cases of 15-year vesting, such as in New York, but these are rare and we would be inclined to look with favor on any provision that would establish a 10-year vesting. Because of the dangerous nature of our work, many officers feel that they are not capable, or desirous of staying in police service, but because of the lack of vesting are reluctant to leave. They feel that after serving 10 or more years, they are sacrificing too much of their careers just to walk away without any tangible reward for those years. I am sure that a vesting program could be worked out that would be able to accommodate the differences in retirement age currently in practice in existing plans.

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We cannot agree with any plan that would tie social security benefits into pension benefits. In police systems, the pension benefit has either been negotiated or legislated as an employee benefit and should not be reduced or limited upon the attainment of coverage under social

security. In many cities, officials have attempted to use the cost of social security as a wedge to reduce pension benefits, and as I stated before, this would be the complete destruction of collective bargaining as it now exists.

We will continue to work with this committee in an effort to provide the necessary safeguards to protect our pension fund, but will also continue to reserve the right to oppose any proposal that would reduce current benefits.

Thank you.

Mr. SIMON. Thank you.

If I may digress just slightly from the subject at hand, you mentioned social security benefits. This is going to be an issue that will be coming up again. What would your reaction be to social security programs that would not in any way diminish your present benefits but would add social security benefits on top of whatever other benefits you have?

Obviously if for example you had a police system where you retire at 55, that would not apply. But your fear is a social security system that supplants or diminishes your police pension system. I can understand that. What about as an addition?

Mr. HAWKONSEN. As a supplemental program I have no opposition. But relative to mandatory inclusion of all public employees including police and fire, we would stay in our current position of opposition.

Mr. SIMON. Mr. Erlenborn.

Mr. ERLENBORN. Thank you, Mr. Chairman.

Let me observe that one of the complaints I get continually from my police, particularly police, constituents is that in some jurisdiction here in DePage County they are covered by social security and they point out—I forget what the figures are—something like 6 or 7 percent of their salary is now deducted for their pension. It will be going up to 7 percent, isn't it—6.15 for social security? They complain bitterly about having before taxes the first 13 or more percent of their salary taken for the combination of social security and police pension.

They have asked me to introduce legislation to allow these jurisdictions to opt out of social security because of the burden of payroll tax.

Mr. HAWKONSEN. That has been the consensus of opinion among police groups in the country. I know in some jurisdictions in the east also, specifically New York State, they have the provision where, along with their mandatory pensions, they can also have social security in an optional form.

Mr. ERLENBORN. This, I should observe again, is not part of our hearings today. But it is a subject I think both of us are quite interested in. This bothered me last year in 1977 when we voted on public employee coverage, the fact that most public employee plans are established on the basis of benefits that are considered to be the sole source of income in retirement. In other words they don't take into consideration social security benefits. Many States have constitutional prohibitions against reducing benefits in public pension plans. To cover public employees with social security would probably give them more than was contemplated in retirement income but would also add quite substantially to the burden of the payroll taxes they are paying.

It seems to me that more thought must be given to the merger of these systems. I think we can have a dual system where you have

civil service or public pension and social security. But it ought to be a planned merger rather than just a forced merger.

In the private sector you have both benefits. In the private sector pension benefits are established in light of the anticipation of drawing social security benefits. I think public employees generally would be well served to be under social security. One thing they often forget is not only the retirement benefits but also the disability benefits and survivors' benefits during their working lives, which are of very great value to them, maybe even more important than the retirement benefits.

Mr. SIMON. I agree with my colleague. I think this is something where we have to sit down and see what can be worked out practically that is fair to the policemen or the teachers or whoever it is.

You also have people who fall between the cracks, who are not in your system long enough to be eligible. But yet they are out of the social security system. I had a man who ended up with heart disease, diabetes, and cancer and had been out of one system long enough and not another long enough. He was not eligible for any assistance at all. Obviously they face overwhelming problems.

We thank you very much for your testimony.

Mr. Roeder, we can enter your statement in the record.

Mr. ROEDER. Yes; you have it. Whether you react positively or negatively, I won't read it to you. It is probably of sufficient length that you would like that.

[The prepared statement submitted by Mr. Roeder follows:]

Statement by
Richard G. Roeder, M.A.A.A.
Gabriel, Roeder, Smith & Company
Actuaries and Consultants

AMERICAN PUBLIC EMPLOYEE RETIREMENT PLANS

REGULATION OF OPERATIONS

DISCLOSURE OF CONDITION

In order to evaluate whether or not a human function should be regulated, it is useful to define the function.

The next page contains an outline labelled "DISCLOSURE OF CONDITION". It is the writer's belief that if each public employee retirement plan were now preparing and making readily available information of the type summarized in this outline, any interested party would know the essentials of the plan's operations, and could make an informed judgment about the plan's condition. "Any interested party" is intended in the broadest terms; it would include an individual employee or his/her representative, a member of government management, a citizen or taxpayer, or a credit rating agency.

It is believed that no new regulatory laws would be needed. If a party wished to change benefits, there now exists the mechanics to change benefits. If a party wished to change the financial objective or the manner in which that objective is pursued, there now exists the mechanics to change the financing program. If a party wished to change the investment activity, there now exists the mechanics to change the investment activity.

There are many public plans which now prepare and make readily available the information in the "DISCLOSURE OF CONDITION". Can further regulation of these plans help the financial environment, now or for generations to come?

Public Employee Retirement Plans

DISCLOSURE OF CONDITION

A. Benefits Summary

B. Actuarial Information

1. Financial Objective. Level contribution rates? Increasing contribution rates?

2. Contribution Rate Computations (actuarial valuations)

a. Computed contribution rate amounts.

b. Quality of assumptions. Emphasize economic assumptions.

c. Unfunded accrued liabilities

3. Solvency Tests

4. Certification by authorized actuary

C. Accounting Information

1. Revenues and Expenditures

2. Summary of Reserve Assets

3. Investment Performance

4. Actual Contribution Record

5. Certification by authorized accountant

D. Cumulative Information

Unfortunately, there are many public plans which do not prepare the information in the "DISCLOSURE OF CONDITION". Without this information, an interested party cannot make an informed judgment about the plan's condition. Requiring these plans to develop this information is a form of regulation (and perhaps the form) which defies logical resistance.

To demonstrate and illustrate that the information in the "DISCLOSURE OF CONDITION" need not require material of oppressive length, the Appendix of this statement contains sample information prepared for a city plan.

This Appendix information is illustrative of type, and should not be examined as if engraved in stone (Moses is not likely to appear for these proceedings).

A. Benefits Summary

An interested party needs to know the principal benefits.

B. Actuarial Information

1. Financial Objective. A plan should state if its contribution rate objective is level contribution rates, or increasing contribution rates. The Financing Diagram shows visually that fundamental choice.

2. Contribution Rate Computations. The key results of the actuarial valuations, for an ongoing plan.

Key characteristics of the financial assumptions are displayed, in a manner which permits an experienced observer to make judgments about the reasonableness of the assumptions.

There is information about unfunded accrued liabilities, an item frequently discussed and often misunderstood.

3. Solvency Tests. The page attached is from the Municipal Finance Officers Association Retirement Handbook (Chapter 2).

4. Certification. The actuarial information is certified by an authorized actuary.

C. Accounting Information

1 & 2. Revenues and Expenditures, and Summary of Reserve Assets. These items are largely self-explanatory.

3. Investment Performance. Basic investment results are needed.

4. Contribution Record. This shows what contributions have been made, and are to be compared with the actuary's computed rates.

5. Certification. The accounting information is certified by an authorized accountant.

D. Cumulative Information

Ofter important trends are disclosed best by comparative statements showing development of key amounts over periods of years.

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GOVERNMENT REGULATION

In pension plan operations, as in all human activities, there are deficiencies and failures --- which cannot be completely eliminated by regulation. Perfection in numan affairs is not attainable.

The best result of regulation is to force a number of plans to operate in a more sound manner, as defined by the regulator.

The worst result of regulation is to add an oppressive layer of bureaucratic paperwork on the backs of the plans already operating in a sound manner.

The Pension Task Force's Report indicates that a significant portion of public employee plans are not preparing "DISCLOSURE OF CONDITION" type of information. The portion is large enough that it is likely that at least some additional regulation is appropriate.

If additional regulation is to come, important conditions are (i) the requirements be kept to a minimum, and (ii) the requirements be only items specifically listed in the law --- no providing for "... and such other items as Bureau X may prescribe from time to time".

An important characteristic of "DISCLOSURE OF CONDITION" type of information is that it is not judgmental. No level of benefits is mandated. No type of financing is mandated. No type of investment activity is mandated.

But the essential facts of these activities are told. The people will know the truth. They can then act or not act as they see fit. If they wish changes, the mechanics for change are already in place.

FEDERAL REGULATION OR STATE REGULATION

Regulation can be accomplished by Federal Law or by State Law.

Is the Federal Government likely to give greater wisdom and leadership than State Governments? If the Federal Government regulates, what is the cost in terms of freedom lost by State Governments? These and similar questions are at the heart of this critical judgment.

A combination of regulation is possible. The Federal Government enacts regulations, with delayed implementation and with the provision that if a State Government enacts corresponding regulations before the Federal implementation date, then the State regulates.

There would be Federal regulation only in the States which did not enact their own regulations.

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Regulation is loss of freedom. It is to be hoped that regulation will be considered with the greatest reluctance. More important than regulation is the preservation of a free country.

November 1978
Wheaton, Illinois

Richard G. Roeder

APPENDIX

ILLUSTRATIONS
Showing How Information Might Be Prepared For "DISCLOSURE OF CONDITION"

America City Employees Retirement System

Summary of Benefits & Administrative Structure

IDENTIFICATION:

Plan provisions set forth in City Charter; last amended 12-1-72. Covers all regular full-time employees, except for sworn fire and police personnel and employees of the Department of Water and Power.
Provisions are collectively bargained.

	Type of Covered Employees	
	General	Total
Number of active employees	19,800	19,800
Number of retired employees	4,050	4,050

REGULAR RETIREMENT: (no reduction factor for age).

Eligibility. Age 60 & 10 years service, or compulsory age 70.
Amount. 2% of final average earnings multiplied by years of credited service. "Final average earnings" means highest earnings in 12 consecutive months.* Provision for post-retirement cost of living adjustment of no more than 3% per year.
Employment is not covered by OASDI. Date last changed: 3-29-73.

*Monthly Earnings	Monthly Plan Benefit		
	35 Years	20 Years	10 Years
$ 500	$ 350	$200	$100
700	490	280	140
1,000	700	400	200
2,000	1,400	800	400

EARLY RETIREMENT: (age reduction factor used).

Eligibility. 30 years service, or age 55 & 10 years service.
Amount. Accrued regular retirement benefit, reduced by 1/12 of 4% (.0033) for each month age is younger than 60 years.
Date last changed: 5-1-67.

VESTING:

Eligibility. 5 years continuous service.
Amount. Accrued regular retirement benefit payable beginning at normal retirement age, or reduced benefit at early retirement age.
Date last changed: 5-1-67.

DISABILITY RETIREMENT:

Eligibility. Inability to perform duties of position for any reason (except intemperance or willful misconduct) after 5 years service.
Amount. 1/70 of final average earnings multiplied by years of service. Minimum is 1/3 of final average earnings if could have completed 18 years of service prior to reaching age 60.
Date last changed: 5-1-67.

DEATH BEFORE RETIREMENT:

Eligibility. If member eligible for early retirement, life benefit to surviving spouse (otherwise, refund of accumulated contributions and limited pension to surviving spouse).
Amount. Joint and Survivor actuarial equivalent of deceased member's accrued regular retirement benefit. Limited pension to surviving spouse (if deceased member was not eligible for early retirement) is two monthly payments for each year of service, maximum is 12 payments. Each payment is 1/2 average monthly earnings for the year preceding death.

MEMBER CONTRIBUTIONS:

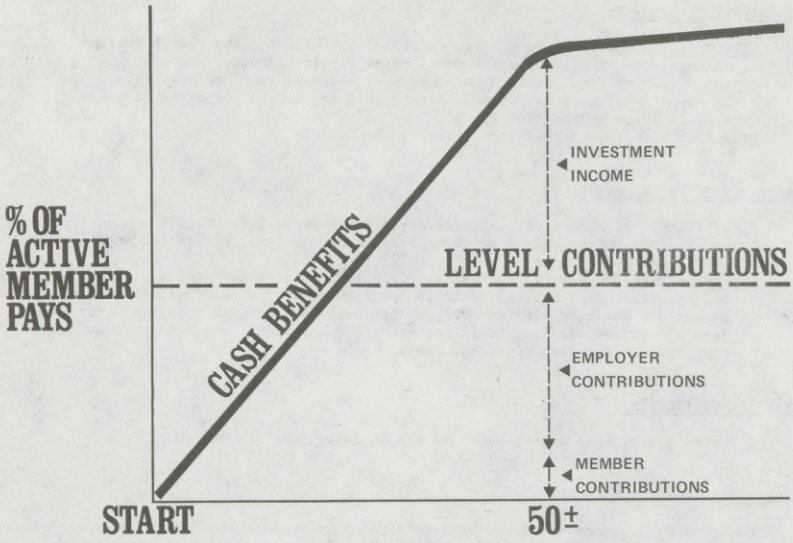
A percentage of base salary based on age at entry into the System.

ADMINISTRATION:

Governed by 5 person board: 2 members elected by membership; 3 members appointed by Mayor with consent of City Council. Board has complete authority over administration of the System.

INVESTMENTS:

Authorized. Debt-type securities legal for savings banks can be a maximum of 100% of the Fund; "Prudent Man" class can be a maximum of 20%; an equity-type security can be a maximum of 25%. The first mortgage & trust deeds of FHA & GI backed loans can be a maximum of 25%. Real property in the City can be a maximum of 10%.
Actual. Using 1-31-73 cost values: 82% in debt-type securities; 18% in equity-type securities.



CASH BENEFITS LINE. This relentlessly increasing line is the fundamental reality of retirement plan financing. It happens each time a new benefit is added (and happens regardless of the financing method being followed).

LEVEL CONTRIBUTION LINE. Determining the level contribution line requires detailed assumptions concerning experience in future decades, including:

Rate of withdrawal of active members (turnover);
Rates of mortality;
Rates of disability;
Ages at actual retirement;
Rates of pay increase;
Investment income;
Change in active member group size.

American City Employees Retirement System

Actuarial Information

Financial Objective.

The financial objective of the retirement system is to establish and receive contributions, expressed as percents of active member payroll, which will remain approximately level from year to year and will not have to be increased for future generations of citizens.

Annual actuarial valuations determine how well the objective is being pursued.

Contribution Rates.

The retirement system is supported by 3 contributors: covered employee contributions of 4% of pay; investment income from invested reserve assets; and actuarially computed employer contributions to provide the remainder necessary.

The employer contribution rates cover both (i) normal cost and (ii) amortizations of unfunded accrued liabilities over periods of future years.

The actuarially computed employer contributions have been:

	Contributions As %s Of Covered Employee Payroll Fiscal Years Ended June 30				
Employer Contributions For	1977	1976	1975	1974	1973
Normal cost	5.34%	5.26	5.31	5.42	5.47
Unfunded accrued liabilities	2.81%	2.83	2.87	2.54	2.41
Total Benefits	8.15%	8.09	8.18	7.96	7.88

The actual contributions for the same years were reported to be:

	1977	1976	1975	1974	1973
			($ in millions)		
a. Employer contributions in $	$14.8	14.1	12.9	11.8	10.8
b. Covered employee payroll $	$182	174	158	148	137
c. Actual employer contribution % (a/b)	8.15%	8.09	8.18	7.96	7.88

Development of Unfunded Accrued Liabilities

	Fiscal Years Ended June 30				
	1977	1976	1975	1974	1973
	($ in millions)				
Computed accrued liabilities	$ 358	325	304	281	255
Less reserve assets	100	86	74	69	55
Unfunded accrued liabilities	$ 258	239	230	212	200
Covered active employees, end:					
Number	20,000	19,800	19,700	19,550	19,425
Annual payroll	$ 184	170	161	150	138
UNFUNDED ACCRUED LIABILITIES / ACTIVE EMPLOYEE PAYROLL (a relative index)	1.40	1.41	1.43	1.41	1.45

In a soundly financed retirement plan, the amount of unfunded accrued liabilities will be controlled and prevented from increasing, except because of benefit increases resulting from legislative change. However, in an inflationary economy, it is seldom practical to impose such controls on dollar amounts, because the value of such dollar amounts is depreciating.

Unfunded accrued liabilities are a form of debt. Active employee payroll is a measure of capacity to service debt. The ratio of the two items provides a relative index of condition. The smaller the index, the stronger the system's financial condition.

MEANING OF "UNFUNDED ACCRUED LIABILITIES"

Almost every pension plan (public or private) has "unfunded accrued liabilities", so whatever they are, they aren't rare. Since the term is not part of everyday conversation, it needs some definition.

"Accrued liabilities" are the present value $ of plan promises to pay benefits in the future based upon service already rendered - - - a liability has been established ("accrued") because the service has been rendered, but the resulting monthly cash benefit may not be payable until years in the future. Accrued liabilities $ are the result of complex mathematical calculations, which are made annually by the plan's actuary (which is the name given to the specialist who makes such calculations).

If "accrued liabilities" at any time exceed the plan's accrued assets (cash & investments), the difference is "unfunded accrued liabilities". This is the common condition. If the plan's assets equalled the plan's "accrued liabilities", the plan would be termed "fully funded". This is a rare condition.

- -

Each time a plan adds a new benefit which applies to service already rendered, an "accrued liability" is created, which is also an "unfunded accrued liability" because the plan can't print instant cash to cover the accrued liability. Payment for such unfunded accrued liabilities is spread over a period of years, commonly in the 25-40 year range.

Unfunded accrued liabilities can occur in another way: if actual financial experience is less favorable than assumed financial experience, the difference is added to unfunded accrued liabilities. In plans where plan benefits are directly related to an employee's pay near time of retirement (a common plan provision) rather than his average pay throughout his working career, unfunded accrued liabilities have been increasing in recent years because unexpected rates of pay increase have created additional accrued liabilities which could not be matched by reasonable investment results. Some of these unexpected pay increases are the direct result of inflation, which is a very destructive force on financial stability.

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The existence of unfunded accrued liabilities is not bad, then (any more than a mortgage on your house is "bad"), but the changes from year to year in amount of unfunded accrued liabilities are important - - - "bad" or "good" or somewhere in between.

Nor are unfunded accrued liabilities a bill payable immediately (your food costs are payable immediately), but it is important that policy-makers prevent the amount from becoming unreasonably high and it is vital that your plan have a sound method for making payments toward them so that they are controlled.

The existence of large amounts of unfunded accrued liabilities indicates that total contributions in past years were less than level - - - an almost certain history if retired life liabilities are not fully funded now.

Solvency Tests

Testing the financial solvency of a retirement system can be done in several ways. Testing for level contribution rates is the way to test for long term fundamental soundness. If the contributions to a system are level in concept and soundly executed, and if the system continues its present operations pattern for the indefinite future, the system will pay all promised benefits when due --- the ultimate financial test.

From the viewpoint that nothing in life continues in its present pattern for the indefinite future, short term solvency tests are appropriate, to see what the condition of the system would be if it were terminated now or in the near future. The system's present assets (cash and investments) are compared with:

(1) the employee contributions (if any) on deposit;

(2) the liabilities for future benefits to present retired lives;

(3) the liabilities for future benefits to former employees with vested rights;

(4) the liabilities for active employees' service already rendered.

In a system that has been using the disciplines of level contribution rate financing, liabilities (1), (2), and (3) will be fully covered by present assets (except in rare circumstances). In addition, liability (4) will be partially covered by the remainder of present assets. The longer the system has been using level financing, the greater the funded portion of liability (4). Liability (4) being fully funded is very rare.

It is wise to pay attention to both long term and short term tests.

	June 30		
	1977	1976	1975
	($ in millions)		
Computed accrued liabilities:			
(1) Employee contributions	$ 21	$ 18	$ 15
(2) Retired lives	38	33	32
(3) Vested terminated lives	2	2	1
(4) Active employees	297	272	256
Reserve assets	100	86	74
Portion of (4) covered by assets	13%	12%	10%

Assumptions (Concerning Future Financial Experiences)
Used by Actuary In Computing Contributions

Assumptions are made in a variety of financial risk areas.

a. Investment Return. 6 percent annually, compounded annually.

b. Individual Employee Pay Increases. An employee's pay is assumed to increase each year, in accordance with a table consisting of a percent increase for each age. For sample ages, the table provides for the following annual increase percents:

Age	% Increase
20	8.0%
30	6.8
40	6.2
50	5.2
60	4.2

c. Age & Service Retirement. According to a table consisting of the percent of eligible employees retiring at each eligible retirement age.

d. Benefit Changes After Retirement. Benefits are assumed to increase each year by 3% of the original benefit amount at retirement.

e. Withdrawal From Employment. According to tables consisting of the percent of active employees withdrawing at each age.

f. Death After Retirement. According to tables consisting of the percent of retired lives dying at each age.

g. Death Before Retirement. According to tables consisting of the percent of active employees dying at each age.

h. Family Composition. Marriage probabilities and an average number of children per family are used in death benefit computations.

i. Disability Retirement. According to tables consisting of the percent of active employees becoming disabled at each age.

j. Funding Method. Entry age method used in determining normal cost and accrued liabilities.

Gains and losses in liabilities resulting from differences between assumed experiences and actual experiences are included in accrued liabilities.

For purposes of determining asset values used in determining unfunded accrued liabilities, common stocks are valued on a 3 year average of market values, and all other assets are valued at amortized cost.

Unfunded accrued liabilities are being financed over a period of 33 years. The annual contributions for unfunded accrued liabilities are level as a percent of active employee payroll, and active employee total payroll is assumed to increase 4 percent annually, compounded annually.

Statement By Actuary Concerning His Opinion Of The Adequacy
Of The Financial Assumptions Used In Computing Contributions

In my opinion the above assumptions are all the significant assumptions in use by the retirement system, and the above assumptions produce results which, in the aggregate, are reasonable.

(signed) , Member
American Academy of Actuaries

American City Employees Retirement System

Accounting Information

Year Ended _____
(Valuation Date)

REVENUES:

a. Member contributions		$_____
b. Employer contributions		_____
c. Investment Income		
1. Interest and Dividends	_____	
2. Gain or (Loss) on Sales	_____	
3. Other	_____	
Total of 1 + 2 + 3		_____
d. Other		_____
e. Total (a + b + c + d)		$_____

EXPENDITURES:

a. Refunds of member contributions	$_____
b. Benefits paid	_____
c. Administrative expenses	_____
d. Other	_____
e. Total	_____

RESERVE INCREASE:

Total revenues minus total expenditures $_____

RESERVES AT _____
(Valuation Date)

ASSETS:

a. Cash and checking	$_____
b. Bank Savings	_____
c. Savings and loan	_____
d. Certificates of deposit	_____
e. U.S. govt. securities	_____
f. Other govt. securities	_____
g. Corporate Bonds	_____
h. Common Stock	_____
i. Other	_____
j. Total (a thru i)	$_____

RESERVE ACCOUNTS:

a. Member contributions	$_____
b. Employer contributions	_____
c. Other	_____
d. Total (a thru c)	$_____

Investment Return: Total % on Average Market

INVESTMENT RESULTS FOR PERIODS ENDED: 9-30-xx

RETIREMENT FUND NAME: _____

	Last Quarter	Annual %, Compounded Annually: Last 1 Year	LAST 3 YEARS	LAST 5 YEARS
Your Retirement Fund results:				
Fixed Income	(2.7)%	(7.0)%	2.5%	5.5%
Common Stock	(4.1)	(7.1)	6.4	8.2
Cash & Temporary	0.9	4.5	4.2	3.9
Total Fund	(3.3)	(7.0)	4.3	6.7
Market Index results:				
S & P Bonds: US Govt Long	(3.4)%	(7.3)%	2.4%	5.3%
S & P Bonds: Corporate "A"	(3.2)	(7.8)	2.2	5.8
S & P Stocks: Composite 500	(0.3)	(8.4)	6.5	8.1

The investment results for one quarter are not conclusive, and probably indicative of performance only in a small way. The main purpose of quarterly compilations is to provide building blocks which can be linked to get annual investment rates.

Investment results over a 3 year period or a 5 year period are significant.

Long range, a fund employing professional management hopes to equal or better the results of a market index in the same investment universe.

Contributions Received.

The specified employee contributions are being made by payroll deductions, and promptly transmitted to the retirement system.

The employer contributions are being contributed in the following manner: at the end of each payroll period, the covered employee payroll for the period is multiplied by the computed employer contribution percent; the resulting dollar amount is paid to the retirement system within 3 days.

Actual employer contributions have been:

	Fiscal Years Ended June 30				
	1977	1976	1975	1974	1973
	($ in millions)				
a. Employer contributions in $	$14.8	14.1	12.9	11.8	10.8
b. Covered employee payroll $	$182	174	158	148	137
c. Actual employer contribution % (a/b)	8.15%	8.09	8.18	7.96	7.88
d. Actuary's computed contribution %	8.15%	8.09	8.18	7.96	7.88

Accountant's Verification of Accuracy of Accounting Information.

In my opinion the preceding information concerning Revenues and Expenditures, Reserve Assets, Investment Performance, and Contributions Received are accurate statements of these activities.

(signed) , Member
Authorized Accountants

STATEMENT OF RICHARD G. ROEDER, M.A.A.A., GABRIEL, ROEDER, SMITH & CO., ACTUARIES AND CONSULTANTS, DETROIT, MICH.

Mr. ROEDER. I should state some things about my background. I am a member of the American Academy of Actuaries. I am with a consulting actuarial firm. While we are listed as Detroit, Mich., we are retained actuaries for plans in approximately 20 States, as far west as Arizona, New Mexico, Colorado, as far south as Texas, Florida, and here in the Great Lakes region there is a heavy concentration.

So we have seen a wide spectrum of the geography of the country. We have fragmentary knowledge also of other plans in the States where we are not retained. We have worked in the field of public employee retirement plans. Our firm goes back to 1938. My own participation goes back to the time when in 1948—which, by subtraction, is 30 years—I will have to tell you I was very young at the time I entered the field.

We are retained by several hundred plans. I myself have seen results of probably I guess—I haven't attempted to count them—thousands of actuarial evaluations. So my background is from that.

From that experience philosophically I would like to make this point about how I think public employee retirement plans ought to conduct their activity. I would refer you to a book titled "Excellence" by former Secretary of HEW John Gardner. I believe in the pursuit of excellence very strongly. We try to carry that out in our work. Sometimes we succeed. Sometimes we don't. It has always been a constant philosophic goal.

When one talks about regulation, as with so many things, that needs definition. In the course of testimony offered this morning certain parts of things that could be called "regulation" have been mentioned.

For me to comment on regulation generally it is necessary for me to define it. Page 2 of my statement has a brief summary of, I think, the areas of activity that I would like to speak to on regulation. I would be glad during the question and answer period to speak to any other aspect in which you might be interested.

As that page 2 indicates, the key is disclosure of condition. I think if you have told to any interested party—I am referring to—there was a comment about "any interested party" and this business of saying, "Well, the participants had this viewpoint, the taxpayers have this, the Government management has this," I think they are really one and the same. I think disclosure of conditions should be in such a form that it is meaningful to all those groups. I think they are all sides of one and the same animal.

For example, if you have a proper benefit summary—I think this is useful—you don't know anything until you know what benefits are promised and as indicated in the appendix to the exhibit, I don't think that needs to be an exhaustive 20-page statement. I think you can do a very effective job in a matter of two or three pages usually, summarizing what the key benefits in the plan are.

The second category is labeled "actuarial information." Necessarily on appropriate occasions the business of actuarial information can get incredibly complex. At its heart I think it is terribly easy. There is a diagram in here. To understand it you don't have to have special ex-

pertise. I think you sort out plans on their financing objective by, "Are you trying to follow level contribution rates principles" or "Are you following increasing cost principles?" You can break them down to that.

The details of it are incredibly complex. But to find out about a plan you ask, "What is your stated objective? If it is a contribution rate of 4-percent employee contributions and 10-percent employer, is it your plan, your objective, to have that constant for the next generation, 25 years from now, the children, grandchildren, 50 years from now and generations to come? Or is your objective something else, increasing costs?"

Of course the classic example of increasing costs is the biggest plan in the country, social security. But I think if a plan makes a statement that they are trying to pursue a level cost objective or they are not, then you get into some of the details which follow. Here is where an actuary is, I am afraid, a necessary evil, to tell how you execute, if you are pursuing a level cost objective or you are not pursuing a level cost objective. I suppose you still need an actuary as you do with social security actuary work to tell you how high it is going to get when it levels off.

There has been some excellent quality work done by the social security actuary on that point.

Most people when they talk about such vague undefined things as "actuarial requirements," which by itself has no meaning—there are a number of plans in the country that say, "We will contribute according to actuarial requirements." Somebody says, "What does that mean?" The answer is "Nothing." This is what you have to get precisely if levels are increasing and how calculated.

In making that calculation of what the level rate is an actuary must work with a variety of assumptions, something less than 10 usually key risk areas. This is where the complexity starts. This is where very different numbers can come out, as your previous work would indicate.

But I think you can get in rather condensed summary form the essence of the assumptions used in calculating that level of contribution and thus be in a position to make a value judgment on it. For example if you see somebody with an actuarial evaluation that looks all great in format, you see a 7-percent investment return. It has zero pay increases assumed. Anybody that is knowledgeable in this field knows you have got a bum set of numbers. This is why it has been folly and continues to be folly to compare the numbers of one State with another when they are computed on totally—not "totally," I am overstating or overreacting the way so many people get—it would be a miracle if they were on the same assumptions. You can't say that State X is at 10 million unfunded, State Y at 15 and have any meaning unless they are using the same assumptions. They are not. I am not saying they should.

But this notion, which goes to the third part that you see there, "Unfunded accrued liabilities," which I would like to stay clear of because I think there is so much misinformation about what they are and what they mean that to try to go into it is folly.

Go back to the level contribution rate. The quality of assumptions put into that calculation. OK. Hopefully that gives you your objective. You know the plan, whether its level is increasing, the financial

objective and the assumptions that are being used to execute that announced plan.

"Accounting information," I think you need to have that.

"Revenues and expenditures." And here, one of the leading public accountants in the country told me really to test out the quality of a plan, its financial structure, you really don't need that. I am more inclined to agree with him than not. But if it is missing, everybody is going to want to know how much they took in and paid out last year. It is very incidental information to really understand the underlying soundness of that structure. But everybody expects it so we have it.

"Summary of reserve assets," meaning what are your cash investment values, the usual sorts of things, market and some kind of book values.

"Investment performance" is important because it is the third contributor to most public employee plans. You have three factors supplying money to support the structure: employee contributions, employer contributions, and investment income. So you do need to now something about the quality of that investment activity. That in itself can lead to a great many pages. But it need not be complex.

There is a one-page summary indicated in the appendix, an example of a very short form. If you knew that about every plan, I am not sure you would really want to go much further in probing them and poking them and testing them for reasonable soundness.

Carrying out disclosure of key points need not be an extremely voluminous thing. In fact if it is voluminous you are probably going to obscure the main point and substance of the material.

A key thing that accounting information can do is to determine the actual contribution record, particularly as a percent of payroll, actual contribution record to be compared with what the actuary computed and then a certification by an authorized accountant.

Yes, I have introduced the phrase. I hope nobody else has used it. I don't know what an "authorized accountant" is. I will let somebody else argue that point. I was deathly afraid I would come in and somebody would say, "Well, there is a group in Oklahoma named 'Authorized Accountants.'" I would be under suit. Let somebody else referee who has appropriate expertise to make that certification.

If you know those things about a plan, I think this is sufficient.

Now let me display another bias. Of the hundreds of plans that I come to, most of them probably wouldn't have hired my firm if they didn't share my beliefs about what is appropriate to pursue excellence. So to say that this would change the lives of many of my clients is not true. They are perhaps typified by—although they are not clients—Chicago teachers, who say, "Hey, we are doing things the right way. Why should we have this?" I would come back to that.

If the key thing in all of this is disclosure—and this is a point where I would depart any technical expertise as an actuary—I would introduce the suggestion of a judgment on which everybody in this room, I think, is equal, enforcement. Once you say, "Here are the standards. Here is the way you should live, here are the things you should do," do you go after them and say, "Because you should do it, you have to do it?"

I would use as an example a client of more than two decades, a very major State plan for whom we have made actuarial calculations and all that time calculating the level cost rates, hopefully using assumptions that are basically reasonable sound assumptions for the real world.

That State has never once contributed the amounts that have been indicated in our report, not once. I think one of the sensitive judgements that must be made is what should you do about it if the information is there and it is public. Why they haven't done anything, I don't know.

What I would suggest is perhaps in the interest of freedom you should let them go. The record is there. There world is closing in on them. We have got a few newspapers that are picking up copies of our report. One time one of the proudest concluding comments I put in a report was, if you will indulge me, "Even Paul Revere's ride would have come to nothing if the people had not listened."

We have testified against that State in court. I was sure they would fire us. After that report went out, I was sure they would fire us. But several years have gone by since both of those incidents.

This is not a perfect world. We cannot be our brother's keeper. They have the right information. The Governor of that particular State has known about that condition for 20 years and doesn't even want to talk about it any more.

Mr. ERLENBORN. Do you know if he has read your report and comment?

Mr. ROEDER. Absolutely. I had a private interview with him. Incidentally, the political forces on that is one of the fascinating things. Many people, as you know, find problems with the way Federal retirement plans are funded. Many people—what is the phrase of yesteryear? "Leave them to Heaven." The record is out.

My point is this: Get this information to the people, all the people, any interested parties. If they don't do anything about it, that is their problem.

This business of mandating somebody to do what you really believe with all your heart and soul to be right is a very delicate thing. I would remind you that most of the greatest sins in the history of mankind have been by people who were sure they were right and had to make the others follow, even to the point of killing them.

I am a firm believer in "Know the truth and let what happen happen." But this is why I think——

Mr. SIMON. You are not advocating capital punishment in this area.

Mr. ROEDER. I have been thinking about that one, too.

Thus from the viewpoint of my clientele, most of them don't want it, because they are already doing it.

I would like to comment about the hardship if these plans were to comply with some Federal regulation. The immediate burden would be very nominal. I think this has been indicated and you have already known. There is great fear of a potential burden of giving to a Federal agency the power to regulate. Maybe the initial form of regulation that is being talked about in this bill—and I should state that I had not read the provisions of the bill at the time this statement was pre-

pared, and I would be glad to go into it at some other time on the details because I think the cause of excellence would be better served by not seeing what was in the initial draft—the potential burden is what scares most of our clients.

Having worked to a considerable extent in the private sector and seen the power of the Internal Revenue Service in the private plans, both pre-ERISA and post-ERISA, this is an ominous thing. Just the other day one of our younger actuaries was bringing to me six changes he was being required to make in a plan in the private sector by an IRS agent who had little comprehension of the plan he was dealing with. But he had the power. We are making six changes in it that are garbage and are going to be expensive and are not going to help the pursuit of excellence.

It is this thing that people fear. I think these clients that are doing all right on their own, this is really at the heart of their concern about it, a Federal bureaucracy.

I would also make this comment, again hopefully not a meaningless colloquialism: I think the "goldfish bowl" is the key difference between the public sector and the private. Compared to the sins of commission that have occurred in the public sector that we have seen compared to the private sector, they are many fewer. They may be the ones that hit the newspapers because a public or quasi-public entity, such as many of our clients are, have to respond to news media. But the bodies I have seen buried in the private sector outnumber by a multiple of several times.

Another thing: These horror stories about individuals being deprived of benefits, this is one of the problems with some of the committee's work. Some of my clients, most of my clients, believe the emphasis on some of the horror stories. But on a proportional basis there are very few individuals hurt badly by activity in the public sector.

Under questioning I might tell you which of the interested parties in the public plans are suffering most, whether it is Government management, individual employees, or the citizens at large. I have a very firm opinion about which group is getting least well treated right now. I think that is the point of this. If there are sins in the public sector, it is commission, not omission. I was introduced to that several decades ago by a veteran political figure. When I was screaming about an activity of one of our major clients in which we were mutually interested, I said, "They are not doing it. It is going to hurt the State." He said, "You don't understand. There are no sins of omission in the public sector. You never get in trouble for what you don't do." I was really shocked by that at the time. I think with the wisdom of advancing age that he was much more right than not. If there are sins, don't look for the horror stories of things they have done. Look for things they haven't done.

Let me move to another sector. What about those plans that aren't well run? This is undoubtedly the most powerful element you have going for regulation by somebody. I haven't addressed by who it is. I think the citizens of any jurisdiction are entitled to know the conditions as outlined here, what the benefits are, what are your objectives, how well are you pursuing it, and are the records straight?

I reluctantly moved into a pro-regulation stance within that definition of what regulations the citizens are entitled to know. Citizens include individual members and everybody in the community. On the Federal versus State, I mention this, very strongly underlined, to stress the Federal regulation, and mention was made earlier during this hearing of the Stone bill. In many versions of that Stone bill that took place early this year, whether you gentlemen were interested observers or active, when attempts were made to put some modification of that thing in the general tax bill that was passed recently, this has to do mostly with coordinating public employee retirement, there were representatives of most if not all of the key sectors of the public planning industry, this is basically a nonregulation group, basically a group that is running its life well.

But they came to this view: That if there were some Federal standards of a specific limited nature—by "limited," it is important that that word needs expansion—and such information that may be requested from time to time by Federal Bureau X, no blank checks. If you want something, it has got to be specific. It has got to be in the law. No open-ended regulation.

The Coordinating Council was looking at some very specific things, somewhat more limited than this outline, that if a State could enact similar things within a period of time, then there would not be Federal regulation in that State. There was even talk about a device I had never heard of, something called Governor's certification. How do you find out unless the State passes some cookie cutter, exactly the same as the Federal, how would you know that a State had? They mentioned a device that apparently has been used in Federal-State relations called a Governor's certification where the Governor says, "I have looked at law such and such. In our State we have such a law and we are administering it."

So you might have a Federal law passed with a delayed implementation. I heard a number mentioned in Washington. I don't know where it came from, 1981.

There are several States here in this room that I know of that have in present State law something that is more comprehensive than what I have inidcated in this disclosure statement. "But that State would then go its own way," this would be your response. If Illinois has a set of laws, there is implementation and enforcement. Those are tricky parts sometimes. There are fine laws in the books and improper enforcement. But judging by the experience of listening to people at the Coordinating Council, that might be the one way that the basic concept of States' rights could be honored.

There would be some States subject to Federal regulation, so that all States would enact such laws. You can't get 50 of any human activity to do anything simultaneously. Who knows how many would enact State laws and how many would be left to the Federal sector?

I would like to underline back a point that was made earlier. In the police and fire matters, you seem particularly interested. I have seen several hundred of those in a variety of States. They are interesting plans in many ways because they are volatile. They have a wider range of performance than just about anything. Again, generality is a problem. Many of them are extremely well run. Some of them are unbelievably inept administratively.

I would make one last commercial before the questions and answers. Certainly the greatest thing, Federal activity, for Federal employee plans, is to stop inflation. If inflation rates in the last 10 years continue, you can pass all the regulations you want, and a level contribution rate objective cannot be followed in an economy that is dedicated to perpetual inflation. This overwhelms everything else. I would like to underline that.

Thank you for your attention. Now I would be glad to answer any questions you might have.

Mr. SIMON. Thank you, Mr. Roeder.

Your last point, you will find that we are in complete agreement with you on that. I was interested that you suggested the same thing that Dr. Winklevoss suggested.

Mr. ROEDER. I think both of us had been preceded by wiser heads than ourselves on that one. I don't think we created it.

Mr. SIMON. The idea does intrigue me.

Mr. ERLENBORN. We will still call it the Winklevoss-Roeder proposition.

Mr. SIMON. You stayed clear of the phrase "unfunded accrued liabilities." You say if we are to provide actuarial information we have to provide some sense of what the liabilities are, whether you call it unfunded accrued liabilities or what. You are not opposed to some indication of the liability?

Mr. ROEDER. No; I am not opposed to it, for the reason I think any statement made by an actuary that didn't include that would be defind to be an incomplete statement by popular understanding. Therefore, not to be accused of making an incomplete statement, I would want it in there.

I go back to what I think is really the important thing. Do you want to go increasing cost or level? I am biased. I want to go level. Let me finish the statement of what I think for me would be a complete statement. What is the quality of the calculation, assuming you have passed hurdle one, we are going to go for level contributions. OK. What is the quality of the execution? Did you use reasonable assumptions in calculating the amount? There are some bum actuaries around. This is why you have to check that.

I have been shocked incidentally in the last 10 years by some of the stuff I have seen. I used to think my profession was absolutely the only perfect one in the world. It isn't, which other people have known for longer than I have, I am sure.

What is the quality of the assumptions? Then there is your rate. Are you paying? You don't have to talk unfunded accrued liabilities or anything else. What is your objective? Have you soundly calculated it and are you putting it in? You don't really need to know anything. The rest of it is detail.

Along the way you calculate unfunded accrued and other things that have a dramatic impact. But they are not essential to achieving your goal. The reason it is in here is for the simple reason, "He can't know much because he didn't say anything about it." That is why it is here.

Let me say this about it though. I think we are stuck with it. People overemphasize it. There is also on page 12 talking about the meaning

of unfunded accrued liability, trying to cool people off from giving sensationalist interpretations to it.

There is a game I am playing with you on page 11. Russ will go through it and lead you through it. You will see that unfunded accrued liabilities have gone from 1973 in this hypothetical illustration 200 million to 1977, 250 million. There are too many people who would look at that and say, "That plan is going to hell." My point is, that plan may not be going to hell at all and it may in fact be at a very controlled level cost situation.

It is the last line below it which is the ratio of the unfunded accrued liabilities divided by the payroll, which I think is a much more reliable index of whether the plan is getting weaker financially or stronger. In an inflationary time when the dollar is changing meaning every day, too many people have simply looked at dollars for a period of time and have come up with wrong interpretations. This is why that index is there. This is why it scares me. We have too many people meddling with it. The brokerage industry came out with a list of unfunded accrued liabilities by State that was a disaster. They had one State leading with zero just by the fact that they had some questionable actuarial calculation that didn't lead to a number in some report labeled, "unfunded accrued." They don't have any. Aren't they wonderful? That State was not in good condition.

Mr. SIMON. Mr. Erlenborn.

Mr. ERLENBORN. Thank you. I have no questions.

Thank you, Mr. Roeder, for an excellent presentation.

Mr. SIMON. Mr. Thomas Leddy. I want to thank Mr. Leddy. I think he was the first witness here. He is very patient.

Mr. LEDDY. I enjoyed listening to all the others.

[Summary statement submitted by Mr. Leddy follows:]

SUMMARY STATEMENT OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

The American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to present this statement to you on House Bill H.R. 14138. My name is Thomas Leddy. Mr. Wade Williams is accompanying me. I am a member of the Institute's Employee Benefit Plans and ERISA Committee. Mr. Williams is the director of the Institute's Federal Legislative Affairs division. Our principal recommendations relate to the provisions of H.R. 14138 that discuss the scope of the auditor's examination of plan financial statements.

Section 103 of H.R. 14138 requires the plan administrator of a State and local public employee benefit plan to engage an independent auditor to examine the financial statements of the plan in accordance with generally accepted auditing standards. However, as presently drafted, the bill would also require the plan administrator to restrict the scope of the auditor's examination with respect to the two most significant items in the financial statements of the plan, that is, the investments and actuarial information of the plan.

The AICPA believes that plan participants will not be provided the assurance contemplated by H.R. 14138 if the scope of the independent auditor's examination does not include a plan's investments and actuarial information because the certification by others, such as a bank, insurance carrier, or an actuary, that the investments and actuarial information of the plan are accurate or correct would not constitute an independent audit of those items.

Credit grantors, investors, and regulatory agencies such as the Securities and Exchange Commission have long recognized the need for unrestricted independent audits of financial statements. Over the past fifty years, the accounting profession has developed standards for auditors to follow in making examinations of financial statements. Those standards are commonly referred

to as generally accepted auditing standards. Users are provided assurance when the independent auditor is able through his examination, to determine that all important matters have been disclosed, that the financial statements are presented fairly in conformity with generally accepted accounting principles, and that those principles have been followed consistently. Whether or not financial statements of State and local public employee benefit plans should be audited is a matter of public policy, which should be based on the cost/benefits of having independent audits of those plans. If the Congress believes that independent audits are warranted, the AICPA believes that the independent auditor's examination should not be restricted.

A certification by a bank or an insurance carrier on the accuracy of a plan's investment assets or a certification by an enrolled actuary on the correctness of the actuarial information of the plan is not, but itself, sufficient audit evidence for an auditor to express an unqualified opinion on the financial statements of a plan because the information that is being certified as accurate or correct is being done so by the person who originated the information in the first place. The amount and kinds of evidential matter required to support an informed opinion are matters for the independent auditor to determine in the exercise of his professional judgment after a careful study of the circumstances in the particular case. In making such decisions, the auditor considers the nature of the item under examination; the materiality of possible errors and irregularities; the degree of risk involved, which is dependent on the adequacy of the internal control and susceptibility of the given item to conversion, manipulation, or misstatement; and the kinds and competence of evidential matter available.

We agree that the cost of many plan auditors visiting banks and insurance carriers may exceed the related benefits. That is not to say though that an unrestricted scope audit will always require the plan auditor to visit the bank or insurance carrier holding the plan's investment assets because the plan auditor could use what has become known in the auditing profession as the "single auditor approach."

Under that approach, the plan auditor would obtain from the auditor of the bank or insurance carrier, a report that provides assurance that the necessary procedures and review of internal accounting control of the appropriate bank or insurance carrier operations were performed. That assurance, when coupled with auditing procedures on information regarding plan transactions prepared by the investment trustee and forwarded to the plan administrator, ordinarily would be sufficient competent evidential matter to enable the plan auditor to express an unqualified opinion on the financial statements of the plan. Alternatively, it also may be possible under certain circumstances to obtain a confirmation from the bank or an insurance carrier which, when coupled with other auditing procedures, would satisfy generally accepted auditing standards; however, the independent auditor must be free to make that decision based on the circumstances.

It is important to recognize that although banks and insurance carriers are subject to periodic examinations by State or Federal authorities, those authorities and the objective of their examination procedures are concerned with the solvency of the institutions and not with the review of internal accounting controls of banks' trust departments or insurance carriers' insurance contract operations nor with the examination of transactions relating to the assets of an individual plan.

Information in plan financial statements ordinarily includes data, which may be based on actuarial calculations. In examining that information in accordance with generally accepted auditing standards, the independent auditor would use the work of an actuary.

However, using the work of an actuary differs from relying on that work. Generally accepted auditing standards require the independent auditor to satisfy himself concerning the professional qualifications and reputation of the actuary whose work he intends to use, make reasonable inquiries of the actuary, and test the census data that was provided to the actuary. Ordinarily, the independent auditor would use the work of an actuary unless his auditing procedures lead him to believe that the actuary's report is unreasonable in the circumstances.

The independent auditor must be able to make reasonable inquiries of the actuary for several reasons. First of all, actuaries ordinarily do not test the validity of the census data that is provided to them by the plan administrator.

Consequently, the independent auditor must determine that the actuary used the same census data that the auditor tested during his audit. In addition, the auditor must be ble to inquire of the actuary about actuarial assumptions included in the actuary's report if the auditor believes that one or more of them may be unreasonable in the circumstances based on the auditors knowledge of the plan. For example, if the actuary used an employee turnover assumption of 5 percent and the independent auditor is aware that the experience of the plan is 50 percent, the independent auditor should be free to discuss with the actuary the basis for the employee turnover assumption.

If the independent auditor is precluded from applying to plan financial statements the auditing procedures that he considers necessary in the circumstances, which would happen if H.R. 14138 were adopted as presently drafted, generally accepted auditing standards would require the independent auditor to disclaim an opinion on the financial statements of the plan because of the significant restriction on the scope of the auditor's examination. The AICPA believes that the plan participants will not be provided the assurance contemplated by H.R. 14138 if the independent auditor disclaims an opinion on the financial statements of a State and local public employee benefit plan.

We wish to thank you for the opportunity to present this statement. The AICPA supports your efforts to establish disclosure and reporting requirements for State and local public employee benefit plans and we look forward to the opportunity to assist you or your staff in that regard. For your convenience, we are attaching our "Recommended Changes to H.R. 14138" which explain in more detail our recommendations concerning changes to the legislation. We request that our oral presentation and recommended changes to H.R. 14138 be made part of the official record of these hearings.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS PUBLIC EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1978—RECOMMENDED CHANGES TO H.R. 14138

1. EXAMINATION OF PLAN ASSETS

Legislative recommendation

Revise subsection 103(a) (3) (A) of H.R. 14138 to read as follows:

The administrator of a plan shall engage, on behalf of all plan participants, an independent public accountant who shall conduct an examination of the financial statements of the plan and express an opinion as to whether the financial statements taken as a whole required to be included in the annual report of subsection (b) of this section are presented fairly in conformity with generally accepted accounting principles applied on a consistent basis. Such examination shall be conducted in accordance with generally accepted auditing standards and, accordingly shall include such tests of the accounting records and such other auditing procedures as the independent public accountant considers necessary in the circumstances. The independent public accountant shall also express an opinion as to whether the separate schedules specified in subsection (b) (2) of this section present fairly in all material respects the information contained therein when considered in conjunction with the financial statements taken as a whole. The opinion of the independent public accountant shall be made a part of the annual report. In a case where a plan is not required to file an annual report, the requirements of this paragraph shall not apply. In a case where by reason of section 104(a) (2) a plan is required only to file a simplified annual report, the Secretary may waive the requirements of this paragraph.

Reasons for legislative recommendation

Subsection 103(a) (3) (A) of H.R. 14138 would require the administrator of a State and local public employee benefit plan to engage an independent accountant to make an examination of the financial statements of the plan in accordance with generally accepted auditing standards and to express an opinion on whether the financial statements required to be included in the plan's annual report are presented fairly in conformity with generally accepted accounting principles. However, subsection 103(a) (3) (A) also refers to subsection 103(a) (3) (C), which provides that the independent accountant shall not express an opinion on statements of a common or collective trust or a separate trust maintained by a bank or a separate account maintained by an insurance carrier. Those statements are required by subsection 103(b) (2) (G) to be included in the annual report

under the schedule requirements. The foregoing subsections are reproduced as Exhibit 1.

A certification by a bank on the accuracy of the statement of a separate trust is not, by itself, sufficient audit evidence to enable an independent accountant to express an opinion on plan financial statements, where the plan has a material amount of its assets in a bank or with an insurance carrier. As a result, if the independent accountant is precluded from applying to those assets the auditing procedures that he considers necessary in the circumstances, the scope of the accountant's examination has been restricted. Generally accepted auditing standards require an independent accountant to disclaim an opinion on financial statements if the scope of his examination is significantly restricted.

The AICPA believes that plan participants will not be provided the assurance contemplated by H.R. 14138 if the independent accountant's examination is restricted to exclude assets held in a bank or with an insurance carrier as permitted by subsection 103(a)(3)(C) of the legislation. It is important to recognize that examinations of plans' financial statements in accordance with generally accepted auditing standards will not necessarily result in each plan auditor visiting banks and insurance carriers holding plans' assets. We agree with the apparent view of Congress that the cost of many plan auditors visiting banks and insurance carriers may exceed the related benefits. But an audit of a plan conducted in accordance with generally accepted auditing standards could involve what has become known in the auditing profession as the "single auditor approach." Under that approach, each plan auditor would obtain from the auditor of the plan's bank or insurance carrier a report which provides assurance that the necessary auditing procedures were performed. When coupled with procedures performed at the plan, the plan auditor may express an opinion that the examination of the plan's financial statements was made in accordance with generally accepted auditing standards. Under certain circumstances, obtaining a confirmation from a bank or insurance carrier would, when coupled with other auditing procedures, satisfy generally accepted auditing standards. In addition, it is important to note that although banks and insurance carriers are subject to periodic examination by state or Federal authorities, those authorities are primarily interested in the solvency of those institutions and not with the review of internal accounting controls nor with the examination of transactions relating to the assets of an individual plan.

We believe that examinations of plan financial statements in accordance with generally accepted auditing standards would provide an element of assurance to plan participants as well as auxiliary benefits to all interested parties.

As background information, we would like to briefly discuss the benefits of an independent audit of financial statements.

An "audit" is an examination of financial statements made in accordance with generally accepted auditing standards by auditor who is independent of the preparation of the financial statements and indeed independent of the client.

In their capacity as independent auditors, certified public accountants have one important objective; namely, to perform an examination that will enable them to express an opinion on whether the representations contained in the client's financial statements present fairly financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles applied on a consistent basis.

The audit must be conducted in accordance with professional standards. Professional standards for auditing are promulgated by the AICPA. Accounting standards, which establish generally accepted accounting principles, are promulgated by the Financial Accounting Standards Board (FASB).

In performing an examination, the independent auditor seeks to determine, among other things, that all important matters have been disclosed, that the financial statements are in accordance with generally accepted accounting principles, and that those principles have been followed consistently. The independent auditor's examination includes only those auditing procedures that, in his judgment, are necessary to enable him to express an opinion on the client's financial statements. That means that the auditor has examined the financial statements in accordance with the standards of the profession and is willing to be held responsible for his opinion. It implies an orderly process of reasoning from particular facts to a specific conclusion about a course of action, a process that has to be both practical and logical.

The independent auditor is not an originator of either the financial statements nor the data from which the financial statements are prepared. The financial state-

ments and the systems, procedures, policies, and decisions that support them are primarily the responsibility of management because management alone can control the systems and the people, make the decisions for the plan, and directly know the bases for and consequences of those decisions. Professional standards preclude the independent auditor from creating financial data and permit him only to express an opinion on its presentation. Furthermore, the auditor must be independent; that is, "he must be without bias with repect to the client under audit, since otherwise he would lack the impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be" (section 220.02 of Statement on Auditing Standards No. 1).

To fulfill his responsibilities, the independent auditor must be in a position to challenge all aspects of the financial statements including amounts determined by the client and those determined by specialists that the client uses.

The primary benefit of an independent audit is the auditor's independence, objectivity, and opinion on the financial statements. An auditor's independence and objectivity must be visible and explicit because parties other than his client also benefit from his work. Those parties include stockholders, plan beneficiaries, lenders, regulatory agencies, and other interested parties. Clearly, the opinion of an independent auditor has little value unless it rests unquestionably on the integrity, independence, and objectivity of the accountant. The independent auditor's role is unique; only he is in a position to perform an audit and express an independent opinion on the financial statements taken as a whole, thus lending credibility to management's representations.

2. EXAMINATION OF ACTUARIAL INFORMATION

Legislative recommendation

Delete subsection 103(a)(3)(B) of H.R. 14138.

Reasons for legislative recommendation

Section 103(a)(3)(B) of H.R. 14138 provides that in expressing an opinion on plan financial statements, "the accountant shall rely on the correctness of any actuarial matter certified to by an enrolled actuary."

Actuarial information has a major impact on financial statements presented in conformity with generally accepted accounting principles of an employee benefit plan. The April 14, 1977 FASB exposure draft, Accounting and Reporting for Defined Benefit Pension Plans, would increase that impact by requiring a statement of accumulated benefits and a statement of changes in those benefits.

Because of the current and expected future impact of actuarial information on plan financial statements, independent auditors need to use the work of actuaries in making their examinations of plan financial statements. However, using the work of an actuary differs from relying on that work. The independent auditor's responsibility in using the work of another professional is set forth in Statement on Auditing Standards No. 11, Using the Work of a Specialist.[1] (A copy of the Statement is enclosed.)

The basic premise of SAS No. 11 is that the independent auditor is not qualified to do the work of a specialist. The independent auditor, however, "may encounter matters potentially material to the fair presentation of financial statements in conformity with generally accepted accounting principles that require special knowledge and that in his judgment require using the work of a specialist" (paragraph 2 of SAS No. 11). The SAS specifically identifies actuaries as persons possessing special skill or knowledge in a field other than accounting and auditing.

SAS No. 11 requires that the independent auditor satisfy himself concerning the professional qualifications and the reputation of the specialist by inquiry or other procedures as appropriate. In addition, paragraph 8 of SAS No. 11 states: "Although the appropriateness and reasonableness of methods or assumptions used and their application are the responsibility of the specialist, the auditor should obtain an understanding of the methods or assumptions used by the specialist to determine whether the findings are suitable for corroborating the repre-

[1] Statements on Auditing Standards are issued by the Auditing Standards Board, the senior technical body of the AICPA designated to issue pronouncements on auditing matters. Rule 202 of the Institute's Code of Professional Ethics requires adherence to the applicable generally accepteed auditing standards promulgated by the Institute. It recognizes Statements on Auditing Standards as interpretations of generally accepted auditing standards and requires that members be prepared to justify departures from those Statements.

sentations in the financial statements. The auditor should consider whether the specialist's finding support the related representations in the financial statements and make appropriate tests of accounting data provided by the client to the specialist." Thus, many (if not most) independent auditors believe that if plan administrators include information that is based on the work of a specialist, such as the results of actuarial valuations, in the financial statements of an employee benefit plan, independent auditors should make reasonable inquiries concerning that information.

(Some independent auditors believe that even if actuarial information on benefit obligations is not presented in a plan's financial statements, the work of an actuarial aspects of contributions received and receivable and benefits paid and payable.)

Paragraph 8 of SAS No. 11 continues: "Ordinarily, the auditor would use the work of the specialist unless his procedures lead him to believe that the findings are unreasonable in the circumstances." Please note the emphasis on the word "use." The SAS does not include the term "rely" because responsibility for the independent auditor's opinion on the financial statements is not divided between the independent auditor and the specialist.

An independent auditor follows the guidance in SAS No. 11 in using the work of many specialists, including actuaries. For example, an independent auditor may need to use the work of a geologist or petroleum reservoir engineer in an examination of the financial statements of a company with oil and gas producing activities, may test revenue recognition on a construction project using estimates of the stage of completion prepared by an engineer, or may satisfy himself as to the carrying basis of real estate investments using the work of an appraiser. The independent auditor's report on the examination of the financial statements ordinarily does not contain a reference to the work that those specialists performed. Neither does the independent auditor's report on the financial statements of an employee benefit plan refer to the work of an actuary.

Paragraph 11 of SAS No. 11 specifically states that "the auditor should not refer to the work or findings of the specialist. Such a reference in an unqualified opinion might be misunderstood to be a qualification of the auditor's opinion or a division of responsibility, neither of which is intended. Further, there may be an inference that the auditor making such reference performed a more thorough audit than an auditor not making such reference." For those reasons, SAS No. 11 prohibits an independent auditor from referring to the specialist in his report unless the independent auditor decides to modify his opinion as a result of the report or findings of the specialist.

Some actuaries may argue that if the independent auditor is unwilling to accept and rely on actuarial matters certified to by an enrolled actuary, then the independent auditor has usurped his function and position. However, section 103 of H.R. 14138 requires that the independent auditor make an examination of the financial statements of the plan and express an opinion on whether those financial statements taken as a whole are presented fairly in conformity with generally accepted accounting principles. To fulfill his responsibilities under H.R. 14138 and under generally accepted auditing standards, the independent auditor must make reasonable inquiries about all aspects of the financial statements of the plan, including amounts determined by the plan's actuary.

The following are types of auditing procedures that many independent auditors might apply to actuarial information that is disclosed in the financial statements of a plan:

(*a*) Obtain a copy of the latest actuarial report on the plan.

(*b*) Inquire about the professional qualifications and reputation of the actuary.

(*c*) Compare the actuarial cost methods and assumptions used with those used in the preceding period.

(*d*) Compare the actuarial information disclosed in the plan's financial statements with related information in the actuarial report.

(*e*) Make appropriate tests of the census data that the plan administrator provided to the actuary.

(*f*) If necessary, make reasonable inquiries of the actuary concerning (a) whether the actuary used the same census data that the independent auditor tested in step *e* and (b) the basis for certain actuarial assumptions if the independent auditor, based on his knowledge of the plan, believes that an assumption is unreasonable in the circumstances. (For example, if the plan actuary used an employee turnover assumption of 5 per year and the independent auditor is aware

that the experience of the plan is 50 per year, the independent auditor would inquire of the plan's actuary regarding the basis for the employee turnover assumption.) Originally, the independent auditor would use the work of the plan's actuary unless the independent auditor's procedures lead him to believe that the actuarial information is unreasonable in the circumstances.

The above procedures do not duplicate the work of the plan's actuary. The purpose of the procedures are to enable the independent auditor to evaluate whether the actuary's report corroborates the representations of the plan administrator that are in the financial statements of the plan.

If the provisions of House Bill H.R. 14138 that would require the independent auditor to rely on the correctness of any actuarial matter certified to by an enrolled actuary are not deleted from the legislation, generally accepted auditing standards would require the independent auditor to disclaim an opinion on a plan's financial statements because the scope of his examination with respect to actuarially determined information of the plan would be significantly restricted. We recommend that subsection 103(a)(3)(B) of H.R. 14138 be deleted so that independent auditors can apply those procedures that in their judgment are necessary in the circumstances.

3. FINANCIAL STATEMENT REQUIREMENTS

Legislative recommendation

Delete subsections 103(b) (1) and (2) and references to them effective on the issuance by the Financial Accounting Standards Board (FASB) of a Statement of Financial Accounting Standards on Accounting and Reporting for Employee Benefit Plans. In addition, do not permit the Internal Revenue Service or the Department of Labor to (a) promulgate accounting principles for employee benefit plans or (b) provide exceptions to generally accepted accounting principles.

Reasons for legislative recommendation

Subsection 103(a)(3)(A) requires that the financial statements of a plan be presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Accounting standards, which establish generally accepted accounting principles, are promulgated by the Financial Accounting Standards Board (FASB).[2] The FASB is currently studying accounting and reporting for employee benefit plans with the intention of issuing a Statement by the end of 1979 that would establish generally accepted accounting principles for those plans. The FASB has issued a discussion memorandum and issued an exposure draft of a Statement entitled, Accounting and Reporting by Defined Benefit Pension Plans.

Subsections 103(b)(1) and (2) prescribe the financial statement and related disclosure requirements for employee welfare benefit plans and employee pension benefit plans, respectively. Those subsections may define, for purposes of complying with H.R. 14138, what is required by generally accepted accounting principles; however, as stated above, those principles are presently being established by the FASB.

4. SCHEDULE REQUIREMENTS

Legislative recommendation

Delete subsection 103(b)(2) of H.R. 14138 and insert in its place:

(2) Those schedules relating to the statement required under paragraph (1) that the Secretary of Labor deems necessary to accomplish the reporting and disclosure objectives of the Act.

Reasons for legislative recommendation

Subsection 103 (b)(2) prescribes the schedules required to be filed as part of the annual report. Those schedules requirements are in some cases duplicative, in other cases burdensome, and the reasons for requiring the information are unclear. For example, subsection 103 (b) (2) (D) requires a detailed schedule of each party-in-interest transaction regardless of size. A similar schedule requirement under ERISA requires only those party-in-interest transactions for which there is not a statutory exemption under Part 4 of Title I or an administrative

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[2] The FASB is an independent organization charged with setting generally accepted accounting principles. Its pronouncements are binding on members of the AICPA and are considered to be authoritative by the Securties and Exchange Commission.

exemption under section 408(a) of ERISA. We believe that the requirement for a detailed schedule of each party-in-interest transaction should be modified to recognize the reduced schedule requirements under section 2520.103-10(b)(3) of the Department of Labor's annual reporting regulations.

EXHIBIT 1—EXCERPTS FROM SECTION 103 OF H.R. 14138, "ANNUAL REPORT"

103(a)(3)(A)

(3)(A) Except as provided in subparagraph (C), the administrator of a plan shall engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an examination of any financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual report by subsection (b) of this section are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards, except as provided in subparagraph (B) and (C), and shall involve such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant . . .

103(a)(3)(C)

(C) The opinion required by subparagraph (A) shall not be expressed as to any statements required by subsection (b)(2)(G) prepared by a bank or similar institution or insurance carrier regulated and supervised and subject to periodic examination by a State or Federal agency if such statements are certified by the bank, similar institution, or insurance carrier as accurate and are made a part of the annual report.

103(b)(2)(G)

(G) If some or all of the assets of a plan or plans are held in a common or collective trust maintained by a bank or similar institution or in a separate account maintained by an insurance carrier or a separate trust maintained by a bank as trustee, the report shall include the most recent annual statement of assets and liabilities of such common or collective trust, and in the case of a separate account or a separate trust, such other information as is required by the administrator in order to comply with this subsection.

Statement on Auditing Standards

December 1975

CPA

Using the Work of a Specialist

1. The purpose of this Statement is to provide guidance to the auditor who uses the work of a specialist in performing an examination of financial statements in accordance with generally accepted auditing standards.[1] For purposes of this Statement, a specialist is a person (or firm) possessing special skill or knowledge in a particular field other than accounting or auditing. Examples of such specialists include actuaries, appraisers, attorneys, engineers, and geologists.[2]

Decision to Use the Work of a Specialist

2. The auditor's education and experience enable him to be knowledgeable about business matters in general, but he is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation. During his examination, however, an auditor may encounter matters potentially material to the fair presentation of financial statements in conformity with generally accepted accounting principles that require special knowledge and that in his judgment require using the work of a specialist.

[1] This Statement does not apply to using the work of a specialist who is a member of the auditor's staff, or to the form or content of letters of audit inquiry concerning litigation, claims, or assessments and lawyers' responses thereto.

[2] For purposes of this Statement, a person whose special skill or knowledge relates to the internal affairs or business practices of the client, such as a credit or plant manager, is not considered a specialist.

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3. Examples of the types of matters that the auditor may decide require him to consider using the work of a specialist include, but are not limited to, the following:

a. Valuation (e.g., works of art, special drugs, and restricted securities).
b. Determination of physical characteristics relating to quantity on hand or condition (e.g., mineral reserves or materials stored in piles above ground).
c. Determination of amounts derived by using specialized techniques or methods (e.g., certain actuarial determinations).
d. Interpretation of technical requirements, regulations, or agreements (e.g., the potential significance of contracts or other legal documents, or legal title to property).

4. In performing an examination of financial statements in accordance with generally accepted auditing standards, the auditor may use the work of a specialist as an audit procedure to obtain competent evidential matter. The circumstances surrounding the use of a specialist differ. Although the familiarity of individual auditors with the work performed by certain types of specialists may differ, the auditing procedures necessary to comply with generally accepted auditing standards need not vary as a result of the extent of the auditor's knowledge.

Selecting a Specialist

5. The auditor should satisfy himself concerning the professional qualifications and reputation of the specialist by inquiry or other procedures, as appropriate. The auditor should consider the following:

a. The professional certification, license, or other recognition of the competence of the specialist in his field, as appropriate.
b. The reputation and standing of the specialist in the views of his peers and others familiar with his capability or performance.
c. The relationship, if any, of the specialist to the client.

6. Ordinarily, the auditor should attempt to obtain a specialist who is unrelated to the client. However, when the circumstances so warrant, work of a specialist having a relationship to the client may be

acceptable (see paragraph 8). Work of a specialist unrelated to the client will usually provide the auditor with greater assurance of reliability because of the absence of a relationship that might impair objectivity.

7. An understanding should exist among the auditor, the client, and the specialist as to the nature of the work to be performed by the specialist. Preferably, the understanding should be documented and should cover the following:

a. The objectives and scope of the specialist's work.
b. The specialist's representations as to his relationship, if any, to the client.
c. The methods or assumptions to be used.
d. A comparison of the methods or assumptions to be used with those used in the preceding period.
e. The specialist's understanding of the auditor's corroborative use of the specialist's findings in relation to the representations in the financial statements.
f. The form and content of the specialist's report that would enable the auditor to make the evaluation described in paragraph 8.

Using the Findings of the Specialist

8. Although the appropriateness and reasonableness of methods or assumptions used and their application are the responsibility of the specialist, the auditor should obtain an understanding of the methods or assumptions used by the specialist to determine whether the findings are suitable for corroborating the representations in the financial statements. The auditor should consider whether the specialist's findings support the related representations in the financial statements and make appropriate tests of accounting data provided by the client to the specialist. Ordinarily, the auditor would use the work of the specialist unless his procedures lead him to believe that the findings are unreasonable in the circumstances. If the specialist is related to the client (see paragraph 6), the auditor should consider performing additional procedures with respect to some or all of the related specialist's assumptions, methods, or findings to determine that the findings are not unreasonable or engage an outside specialist for that purpose.

Effect of the Specialist's Work on the Auditor's Report

9. If the auditor determines that the specialist's findings support the related representations in the financial statements, he may reasonably conclude that he has obtained sufficient competent evidential matter. If there is a material difference between the specialist's findings and the representations in the financial statements, or if the auditor believes that the determinations made by the specialist are unreasonable, he should apply additional procedures. If after applying any additional procedures that might be appropriate he is unable to resolve the matter, the auditor should obtain the opinion of another specialist, unless it appears to the auditor that the matter cannot be resolved. A matter that has not been resolved will ordinarily cause the auditor to conclude that he should qualify his opinion or disclaim an opinion because the inability to obtain sufficient competent evidential matter as to an assertion of material significance in the financial statements constitutes a scope limitation (see SAS No. 2, paragraphs 10 and 11).

10. The auditor may conclude after performing additional procedures, including possibly obtaining the opinion of another specialist, that the representations in the financial statements are not in conformity with generally accepted accounting principles. In that event, he should express a qualified or adverse opinion (see SAS No. 2, paragraphs 15-17).

Reference to the Specialist in the Auditor's Report

11. When expressing an unqualified opinion, the auditor should not refer to the work or findings of the specialist. Such a reference in an unqualified opinion might be misunderstood to be a qualification of the auditor's opinion or a division of responsibility, neither of which is intended. Further, there may be an inference that the auditor making such reference performed a more thorough audit than an auditor not making such reference.

12. If the auditor decides to modify his opinion (see paragraphs 9 and 10) as a result of the report or findings of the specialist, reference to and identification of the specialist may be made in the auditor's report if the auditor believes such reference will facilitate an understanding of the reason for the modification.

The Statement entitled "Using the Work of a Specialist" was adopted unanimously by the twenty-one members of the Committee, of whom three, Messrs. Badecker, Lisk and Nelson, assented with qualifications.

Messrs. Badecker and Lisk approve issuance of this Statement but qualify their assent because they disagree with paragraph 11, which prohibits reference to the specialist in the auditor's unqualified report. They believe there may be circumstances when such reference will serve to better inform the reader as to the nature and character of an examination made in accordance with generally accepted auditing standards and the extent of the auditor's responsibility. They believe that the auditor should be held only to a standard of reasonableness and due care in the selection of the specialist and that silence with respect to the work of the specialist and the auditor's reliance on that work may imply the possession of skills by the auditor in an area in which he lacks qualification.

Mr. Nelson approves issuance of this Statement but qualifies his assent because he believes that the Statement may necessitate changing arrangements previously made with clients and specialists. Consequently, an effective date should be specified to allow for an orderly implementation of the provisions promulgated in the Statement.

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STATEMENT OF THOMAS LEDDY, EMPLOYEE BENEFIT PLANS AND ERISA COMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, ACCOMPANIED BY WADE WILLIAMS, DIRECTOR, FEDERAL LEGISLATIVE AFFAIRS DIVISION, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. LEDDY. The American Institute of Certified Public Accountants appreciates the opportunity of presenting this statement. I would also like to indicate personally having the opportunity to return to DuPage County for quite some time.

My name is Thomas Leddy. Mr. Wade Williams is accompanying me. I am a member of the institute's employee benefits plans and ERISA committee. Mr. Williams is the director of the institute's Federal legislative affairs division. Our principal recommendations relate to the provisions of H.R. 14138 that discuss the scope of the auditor's examination of plan financial statements.

Section 103 of H.R. 14138 requires the plan administrator of a State and local public employee benefit plan to engage an independent auditor to examine the financial statements of the plan in accordance with generally accepted auditing standards. However, as presently drafted, the bill would also require the plan administrator to restrict the scope of the auditor's examination with respect to the two most significant items in the financial statements of the plan, that is, the investments and actuarial information of the plan. The AICPA believes that plan participants will not be provided the assurance contemplated by H.R. 14138 if the scope of the independent auditor's examination does not include a plan's investments and actuarial information because the certification by others, such as a bank, insurance carrier or an actuary that the investments and actuarial information of the plan are accurate or correct would not constitute an independent audit of those items.

Credit grantors, investors and regulatory agencies such as the Securities and Exchange Commission have long recognized the need for unrestricted independent audits of financial statements. Over the past 50 years, the accounting profession has developed standards for auditors to follow in making examinations of financial statements. Those standards are commonly referred to as generally accepted auditing standards. Users are provided assurance when the independent auditor is able through his examination, to determine that all important matters have been disclosed, that the financial statements are presented fairly in conformity with generally accepted accounting principles, and that those principles have been followed consistently. Whether or not financial statements of State and local public employee benefit plans should be audited is a matter of public policy, which should be based on the cost/benefits of having independent audits of those plans. If the Congress believes that independent audits are warranted, the AICPA believes that the independent auditor's examination should not be restricted.

A certification by a bank or an insurance carrier or the accuracy of a plan's investment assets or a certification by an enrolled actuary on the correctness of the actuarial information of the plan is not, by itself,

sufficient audit evidence for an auditor to express an unqualified opinion on the financial statements of a plan because the information that is being certified as accurate or correct is being done so by the person who originated the information in the first place.

The amount and kinds of evidential matter required to support an informed opinion are matters for the independent auditor to determine in the exercise of his professional judgement after a careful study of the circumstances in the particular case. In making such decisions, the auditor considers the nature of the item under examination, the materiality of possible errors and irregularities, the degree of risk involved, which is dependent on the adequacy of the internal control and susceptibility of the given item to conversion, manipulation or misstatement, and the kinds and competence of evidential matter available.

We agree that the cost of many plan auditors visiting banks and insurance carriers may exceed the related benefits. That is not to say though that an unrestricted scope audit will always require the plan auditor to visit the bank or insurance carrier holding the plan's investment assets because the plan auditor could use what has become known in the auditing profession as the "single auditor approach." Under that approach, the plan auditor could obtain from the auditor of the bank or insurance carrier a report that provides assurance that the necessary procedures and review of internal accounting control of the appropriate bank or insurance carrier operations were performed. That assurance, when coupled with auditing procedures on information regarding plan transactions prepared by the investment trustee and forwarded to the plan administrator, ordinarily would be sufficient competent evidential matter to enable the plan auditor to express an unqualified opinion on the financial statements of the plan. Alternatively, it also may be possible under certain circumstances to obtain a confirmation from the bank or an insurance carrier which, when coupled with other auditing procedures, would satisfy generally accepted auditing standards; however, the independent auditor must be free to make that decision based on the circumstances.

It is important to recognize that although banks and insurance carriers are subject to periodic examinations by State or Federal authorities, those authorities and the objective of their examination procedures are concerned with the solvency of the institutions and not with the review of internal accounting controls of banks' trust departments or insurance carriers' insurance contract operations nor with the examination of transactions relating to the assets of an individual plan.

Information in plan financial statements ordinarily includes data which may be based on actuarial calculations. In examining that information in accordance with generally accepted auditing standards, the independent auditor would use the work of an actuary. However, using the work of an actuary differs from relying on that work. Generally accepted auditing standards require the independent auditor to satisfy himself concerning the professional qualifications and reputation of the actuary whose work he intends to use, make reasonable inquiries of the actuary, and test the census data that was provided to the actuary. Ordinarily, the independent auditor would use the work of an actuary unless his auditing procedures lead him to believe that the actuary's report is unreasonable in the circumstances.

The independent auditor must be able to make reasonable inquiries of the actuary for several reasons. First of all, actuaries ordinarily do not test the validity of the census data that is provided to them by the plan administrator. Consequently, the independent auditor must determine that the actuary used the same census data that the auditor tested during his audit. In addition, the auditor must be able to inquire of the actuary about actuarial assumptions included in the actuary's report if the auditor believes that one or more of them may be unreasonable in the circumstances based on the auditor's knowledge of the plan.

For example, if the actuary used an employee turnover assumption of 5 percent and the independent auditor is aware that the experience of the plan is 50 percent, the independent auditor should be free to discuss with the actuary the basis for the employee turnover assumption. This disparity is made here to make a point, not to indicate that this is actually the case.

If the independent auditor is precluded from applying to plan financial statements the auditing procedures that he considers necessary in the circumstances, which would happen if H.R. 14138 were adopted as presently drafted, generally accepted auditing standards would require the independent auditor to disclaim an opinion on the financial statements of the plan because of the significant restriction on the scope of the auditor's examination. The AICPA believes that the plan participants will not be provided the assurance contemplated by H.R. 14138 if the independent auditor disclaims an opinion on the financial statements of a State and local public employee benefit plan.

We wish to thank you for the opportunity to present this statement. The AICPA supports your efforts to establish disclosure and reporting requirements for State and local public employee benefit plans and we look forward to the opportunity to assist you or your staff in that regard. For your convenience, we are attaching our recommended changes to H.R. 14138 which explain in more detail our recommendations concerning changes to the legislation. We request that our oral presentation and recommended changes to H.R. 14138 be made part of the official record of these hearings.

Mr. SIMON. They will be made a part of the record.

What type of increased costs are you talking about?

Mr. LEDDY. Increased costs over what?

Mr. SIMON. When you expand the audit as you are talking about.

Mr. LEDDY. Based on what is currently contemplated basically we would not be able to express an opinion. So it would vary with the individual plan, how the assets were invested, and how many employees were participants.

Mr. SIMON. I don't know if there is such a thing as an average audit. But a plan, let's just say that if a plan with $100 million in assets, it costs now roughly what would you guess?

Mr. LEDDY. As the bill stands right now?

Mr. SIMON. Yes.

Mr. LEDDY. How many participants would there be in such a plan?

Mr. SIMON. 1,000, pulling these figures out of the air.

Mr. LEDDY. I don't think I can give you an answer. It would depend on how they are invested. If they are invested in one investment vehicle it would be a lot more simplified than it would if they were in-

vested in many vehicles. If this was a multilocation plan where the census data, payroll records, would be located in 10 or 15 different locations as opposed to 1 location, the cost would vary significantly as well.

The only experience I can give you is from the private sector. I have been familiar with it under ERISA. I would say the average cost of a full audit of a pension plan could generally be in the range of $5,000 to $20,000, depending on the complexity and size of the plan. There are some that are higher. There are some that are lower. Maybe the $5,000 to $10,000 range would be the mean.

Mr. SIMON. Using the 5 to 20 figure that you are talking about, the kind of increment that you are talking about in auditing, would add what if anything? Again I realize circumstances vary so much.

Mr. LEDDY. I would say it would have a significant impact on it in most cases because the two portions that are being restricted from the scope of examination really are the guts of most plans.

That leads into why we feel if we are not able to audit those two areas, we would be unable to express an opinion on the plan, because what has been excluded from the scope of our audit is so great that what was left to audit wouldn't give us enough competent evidential matter to express a professional opinion.

Mr. SIMON. The aim of the legislation obviously is to keep costs——

Mr. LEDDY. Absolutely.

Mr. SIMON. And everything down to a minimum. I can see the point you make too.

Mr. Erlenborn?

Mr. ERLENBORN. I have no questions. Thank you, Mr. Chairman.

Mr. SIMON. We thank you both very much, for your testimony and your patience.

The final witness, Mr. Dale Gustafson, the president of the American Academy of Actuaries, is not here, I don't believe. But we will enter his testimony in the record and we thank all of you for your presence.

Does anyone else have any words of wisdom?

Mr. KAUSCH. I am not on your written list, Mr. Chairman. But I have submitted copies of my testimony. It is very short. The hour is late.

[The prepared statement of Mr. Kausch follows:]

STATEMENT OF RALPH W. KAUSCH, EXECUTIVE DIRECTOR, ILLINOIS MUNICIPAL RETIREMENT FUND, CHICAGO, ILL.

Congressman Erlenborn, my name is Ralph W. Kausch, and I am the Executive Director of the Illinois Municipal Retirement Fund, a public employee retirement system for 103,000 employees of local governments throughout the State of Illinois. My testimony in opposition to H.R. 14138 will be short and to a specific point.

As a retirement system administrator, it would be rather easy for me to adopt a passive attitude toward this bill. After all the bill does not add any onerous duties to retirement administrators as it merely establishes fiduciary standards which generally are already required by state laws, imposes some reporting requirements which can be met by any system that maintains good records, and requires disclosure of plan provisions which the members of a retirement system are most certainly entitled. There are some who would oppose this bill because it does not address itself to the most serious problem facing the majority of federal, state, and local retirement systems—that is their badly underfunded status.

Nor does it require the hundreds of public employee retirement systems with 20 or nothing vesting provisions to conform to the short vesting standards contained in ERISA.

All in all this bill is simply limited parts of ERISA applied to the public sector. However, what it would result in, I believe, is several hundred additional people at the state and federal levels to comply with its requirements on the one hand and to write regulations and otherwise ensure compliance on the other.

Congressman Erlenborn, that is my basic objection to this bill. Taxpayers all across the land are insisting that Congress stop imposing additional regulatory controls, and that it decrease the burden of taxes upon its citizens. On those points this bill goes against the current grain of public sentiment.

Granted—that this bill would result in no gigantic O.S.H.A. or E.E.O.C., but the federal government already spends an amount equal to 23 percent of this nation's entire gross national product. Without exception every economist I have read or heard indicates that this level of spending is excessive and that this percentage must be reduced. It seems to me the message from the taxpayers is clear enough. They are saying no more—not even a little bit. In light of that sentiment I urge that this bill be tabled or withdrawn.

Thank you for the opportunity of appearing before you.

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Granted, that this bill would result in no gigantic OSHA or EEOC, but the Federal Government already spends an amount equal to 23 percent of this Nation's entire gross national product. Without exception every economist I have read or heard indicates that this level of spending is excessive and that this percentage must be reduced.

It seems to me the message from the taxpayers is clear enough. They are saying, "No more, not even a little bit." In light of that sentiment I urge that this bill be tabled or withdrawn.

Thank you for the opportunity of appearing before you.

I have a final comment to make. It is not in my written statement because I only heard this this morning. But I think you have been presented with an outstanding suggestion from Dr. Winklevoss. That is really related to the point I am making. I am not a shill for Dr. Winklevoss. I don't even know the gentleman. But I think he gave you an idea which really should be pursued. Instead of establishing a bureacracy that is going to require thousands of retirement systems to submit reports that are going to be reviewed by Federal employees, most of which are doing their job adequately, this would direct its attention to the systems that you referred to this morning with abuses and create a much smaller agency that would only go at the abuses and leave the systems alone that are doing the job properly now. I would urge you to follow through with that suggestion from Dr. Winklevoss.

Thank you.

Mr. SIMON. We thank you very much. Incidentally, if it is encouraging to you, we are now below 22 percent.

Mr. KAUSCH. I stand corrected.

Mr. SIMON. If I may, while Roy Baker is here, do you react positively also to this suggestion of Dr. Winklevoss?

Mr. BAKER. Yes. We were just talking about it. It is a reasonable solution to the whole problem.

Mr. KAUSCH. It is what Mr. Roeder was putting his finger on. What we really fear, as retirement administrators, is that a heavyhanded bureacracy will be established to correct the abuses that you are referring to. In effect it swats at flies with a sledgehammer.

Mr. ERLENBORN. Could I comment? It is exactly why we have hearings like this. Sometimes darn good ideas occur as a result of these hearings. A sort of consensus begins to evolve, which I have the feeling is occurring here.

Let me ask a question. How do you measure performance? You can have a Governor certify that there is a law on the books which is complying with the standard. But how are we to know that that law is being enforced?

Mr. KAUSCH. I don't know if you were addressing that question to me or in general.

Mr. ERLENBORN. Any one of you.

Mr. KAUSCH. I was thinking you could pass legislation essentially similar to what you now have. Instead of requiring on an annual basis each retirement system to submit something for review by some Federal employee, dictating the kinds of retirement material that you have to issue, I think sometimes the "tail wags the dog" there. I have field representatives covering this State who come back to me and tell me the most commonly asked questions by members of our retirement system. So we modify our retirement information to explain the benefits as we think they should be explained, then adding into it what we know are the questions most commonly asked.

As someone testified this morning, otherwise you will get somebody at the Federal level with no idea of the requirements of your sys-

tem, dictating to you what your retirement leaflet ought to look like. So it doesn't really cover what it ought to, just what someone thinks it ought to who doesn't know.

Specifically to try to cope with the question you are saying, I would envision something that would, say, review your system one time and give you a badge of conformance, something that says, "Now we don't have to look at you again for 5 years or 10 years and we are going to concentrate our attention where they fall short and where there are abuses." And you would focus on those where there are abuses and leave the ones that are adequately administered alone.

Mr. SIMON. It seems to me we could entrust some agency if there are complaints from AFSCME or from any group that there is not compliance, then you could take a look.

Mr. LEIBIG. I am an attorney, interested in this area. I talked about this with Roy Schotland, who was one of the first witnesses today. While we are somewhat leary of this approach, we being AFSCME, there are some things we think could be workable in it.

I think one of the ways the enforcement could be taken care of is if a person who felt that a State that was supposedly complying, was certified as a certified State, and was in fact not enforcing or complying, if people felt they were injured by that and had a Federal remedy to insure the States were complying.

One of the problems we have had (and actually AFSCME has spent a lot of money on in some cases) is trying to get a State for instance to put up the money they promised to put up. That kind of litigation takes a long time. It is frustrating at the State level. If there were ways of enforcement in the Federal courts, even if it was a State system on disclosure, it might be helpful.

Mr. ERLENBORN. I think you are getting into an area that wouldn't necessarily be covered in this legislation and that is funding.

Mr. LEIBIG. No, no. All I am saying is if you have reporting and disclosure requirements, our problem is the State level funding rule. But the State fiduciaries don't put the money in that is required under the State law. Your complaint isn't that the funding isn't high enough. It is that they are not even obeying their own State rule on what the funding should be.

Mr. SIMON. What you are saying is there would be a Federal remedy also in disclosure.

Mr. LEIBIG. Yes. If the States don't meet their own rules, if you had a remedy, if there was something you could do about it, you could go to the Federal Government and say, "They are not following their own rules."

Mr. SIMON. The last scheduled witness has appeared. Thank you very much, Mr. Kausch, for your statement.

MICHAEL L. MORY, EXECUTIVE SECRETARY, STATE EMPLOYEES' RETIREMENT SYSTEM

Mr. MORY. I am Mike Mory, executive secretary of the State Employees Retirement System. Speaking to this State regulation, Illinois has a mechanism that handles that capacity now. The Illinois Department of Insurance has a provision that does have a quasi-regulatory

authority over all public systems in the State. Practically speaking, because of local police and firemen's funds, the staff operates pretty much within the small fund sector. But certainly that staff could be increased. And if there were consolidation at some point of the small funds accomplished, they currently have the statutory authority necessary to implement this form of regulation at the State level. I think it would be possible to have that agency , whatever it would be, within a State to have a State agency, that in essence we already have, that could certify to the Federal Government compliance with the Federal mandate.

I would also emphasize again the point that Ralph made and some of the other speakers, that almost all the things that are in this bill, the larger systems that all of us represent are doing. The problem is we may not be doing them exactly the way that this bill dictates. That is the part that is kind of hard for me to understand.

In our system of communication for example with our members, to deal with our particular situation, which is not the same as the teachers' system, which is a multiple employer system or a single employer system, there are characteristics that may not be true for policemen and firemen and so forth. I hate to see a situation develop where all of these are rigidly mandated with no flexibility for the system involved. To put this material together in a manner that we know from experience has worked with our members.

We provide benefit estimates now based on the request of the member based on his expected date of retirement. Most people want this kind of information at some point prior to retirement so they can at least reasonably plan for their retirement at some point in the future.

Our basic benefit structure is dictated by the law in effect when a person withdraws from service. When we plan amendments to our benefit program they do not affect inactive vested members. I know that is different from amendments made generally to private sector plans.

So to introduce as a mandate a very rigid structure at the Federal level in instances where the same type of thing is being done but maybe not in that format, thus requiring additional expenses to convert, I just can't see the justification for it.

I would also endorse the recommendation that has been made here that if Federal standards are executed they should be very broad standards that could be enforced by some established agency at the State level. Again I see no need to establish and separate compete new bureaucratic body at the State level. In Illinois the agency could handle this with a minimal increase in staff time.

So I would strongly ask the members of this committee to thoroughly review that type of proposal.

[Statement submitted by Mr. Mory may be found in appendix.]

Mr. SIMON. Thank you.

[Statement submitted by Mr. Kellison follows:]

STATEMENT OF THE AMERICAN ACADEMY OF ACTUARIES ON HR 14138 ("PERISA")

I. INTRODUCTION

The American Academy of Actuaries ("Academy") is pleased to submit these comments on HR 14138, the Public Employee Retirement Income Security Act of

1978 (PERISA). The Academy is vitally interested in this bill, since the large majority of actuaries performing actuarial services for state and local public employee retirement systems are members of the Academy. Appendix A contains some background information about the Academy.

HR 14138 is a very comprehensive bill which has a number of provisions that would affect the work of actuaries in connection with state and local public employee retirement systems. However, we would prefer to comment today on only one aspect of the bill; namely, the relationship between actuaries and accountants under the bill. We would like to study the bill more thoroughly and defer any comments on other aspects of the bill until hearings which we anticipate will be held in 1979.

II. REATIONSHIP BETWEEN ACTUARIES AND ACCOUNTANTS

The relationship between actuaries and accountants under the Employee Retirement Income Security Act of 1974 (ERISA) is important background to consider, since the general framework of PERSIA is analogous to that contained in ERISA in this connection. However, despite the similarity between the two, PERSIA contains some fundamental differences from ERISA which will be discussed later in Section III of this statement.

Section 103 of ERISA appears to create a division of responsibility between actuaries and accountants. The actuary's report is concerned with such items as the determination of present values for future benefit payments and the various computations required to determine whether the plan complies with minimum funding requirements. The accountants' report is concerned with a proper presentation of the financial status of the pension fund itself.

Despite this apparently clear division of responsibility contemplated by ERISA, some differences of opinion have arisen between actuaries and accountants concerning their relative roles under the Act. One major area of difference has involved the wishes of the accounting profession to include actuarial present values in the financial statements of the plan.

ERISA does not require, or even imply. that this was the intent; in fact, there is considerable evidence that Congress intended that such actuarial values not be included in the financial statements of the plan. Current proposals of the accounting profession to include actuarial values in the financial statements rests solely on the broad discretion given the accounting profession to define "generally accepted accounting principles".

The dialogue on this issue has recently been focused on the exposure draft of the Financial Accounting Standards Board (FASB) issued in April, 1977 which attempts to define generally accepted accounting principles for pension plans. That exposure draft, if implemented without change, would lead to the reporting of two sets of actuarial present value figures which are likely to differ substantially—one by the accountant in the plan's financial statements and the other by the actuary in the required actuarial statement. This unfortunate result would produce considerable confusion among plan participants, plan sponsors, and other interested parties.

The Academy believes that requiring actuarial present values to appear in the financial statements of the plan is both unnecessary and confusing, and that Section 103 of ERISA only requires the accountant's report to be concerned with the pension fund itself. However, the FASB has a responsibility for defining generally accepted accounting principles and we recognize that some type of actuarial present value figures may be required by the FASB to appear in the financial statements of the plan. Accordingly, the Academy has participated in extensive discussions with the FASB and the U.S. Department of Labor in attempting to arrive at a mutually acceptable method of determining the present value of accrued benefits for this purpose, if in fact, it is to be included. Considerable progress has been made in this endeavor, although a couple of knotty problems yet remain to be resolved. It is important to stress again that the actuary's report will include actuarial present values for funding purposes which are substantially different from this value which may be required for the financial statements of the plan.

A second unresolved problem area has arisen in the auditing area. Section 103 of ERISA provides that the accountant *may* rely on the correctness of any actuarial matter certified to by an enrolled actuary, if he so states his reliance (and conversely, that actuaries may rely on the work product of qualified ac-

countants in an analogous manner.) However, this provision has never become operational in the manner which Congress intended. This results from audit guidelines (which predate ERISA) of the American Institute of Certified Public Accountants (AICPA) to the effect that any opinion of an auditor which expresses reliance on the work of others becomes a "qualified opinion," with all the resulting negative connotations attached to that term. The AICPA has not changed this position, despite the statutory authority for such an expression of reliance contained in ERISA, although the matter is currently under study.

III. ANALYSIS OF H.R. 14138

Section 103 of PERISA is quite analogous to Section 103 of ERISA in dealing with the relationship between actuaries and accountants with two notable exceptions:

1. Section 103(a)(3)(B) provides that the accountant *shall* rely on the correctness of any actuarial matter certified to by an enrolled actuary. Likewise, Section 103(a)(4)(C) provides for similar reliance by actuaries on accountants. Thus, PERISA changes the *voluntary* reliance of ERISA to *compulsory* reliance.

2. Section 103(a)(3)(A) of ERISA indicates that audits shall be conducted in accordance with "generally accepted auditing standards." Section 103(a)(3)(A) of PERISA contains the same wording, with the important addition that the reliance provisions described above are specifically authorized, even though departing from generally accepted auditing standards as presently defined by the AICPA.

The Academy strongly endorses these two provisions contained in PERISA. We believe that they would be quite beneficial in resolving the difficulties which have arisen under ERISA, as described in Section II of this statement.

In addition, there are a few other amendments which could be made to further clarify the relative roles of the two professions. These amendments are consistent with the intent of H.R. 14138 and are submitted for the consideration of the Committee in Appendix B.

IV. OTHER LEGISLATION

We would also like to call attention to S. 3017 (the William-Javits bill), which is an omnibus ERISA-revision measure that was also introduced in 1978. S. 3017 contains proposed changes to ERISA which would make the two changes described above in Section III of this statement. Thus, on the issue of the relationship between the actuarial and accounting professions there is consistency between S. 3017 and H.R. 14138.

The Academy testified in favor of this portion of S. 3017 at a public hearing held on August 17, 1978. Amendments similar to those contained in Appendix B were also recommended for adoption into S. 3017. We would urge that provisions similar to those contained in H.R. 14138 and S. 3017 be incorporated in any ERISA-revision bills developed in the House of Representatives in the next session of the Congress.

V. SUMMARY

In summary, the Academy strongly supports the provisions of H.R. 14138 concerning the relationship between actuaries and accountants. We would also like to recommend additional amendments which are consistent with the intent of the bill to further clarify this relationship. Finally, we wish to defer until a later date any comments on other aspects of the bill.

APPENDIX A

BACKGROUND INFORMATION ON THE AMERICAN ACADEMY OF ACTUARIES

The American Academy of Actuaries is a professional organization of actuaries which was formed in 1965 to bring together into one organization all actuaries in the United States and to seek accreditation and greater public recognition for the profession. It includes members of four founding organizations—the Casualty Actuarial Society, the Conference of Actuaries in Public Practice, the Fraternal Actuarial Association, and the Society of Actuaries. These organizations, or their predecessors, date back many years, one of them to the late 1800's, so that despite the relatively short duration of its formal existence, the Academy, its founding

organizations and their predecessors have represented the actuarial profession in the United States for over 80 years.

The Academy is unique as the national accrediting actuarial organization for actuaries in all areas of specialization. Requirements to become a member of the Academy can be summarized under two broad headings: (1) education and (2) experience; an individual must satisfy both in order to be admitted. At the present time, the education requirements for full membership can be satisfied only by passing professional examinations given either by the Casualty Actuarial Society or the Society of Actuaries. The experience requirement consists of five years of responsible actuarial work.

As of December 31, 1977, Academy membership stood at 4,418. These actuaries have a variety of types of employment, including insurance organizations, consulting firms, academic institutions, and government. Well over 90 percent of those individuals who have satisfied the rigorous education and experience requirements of the Academy do, in fact, join the Academy. The entire Academy membership is subject to rigorous guides to professional conduct and standards of practice.

APPENDIX B

PROPOSED AMENDMENTS TO H.R. 14138 BY THE AMERICAN ACADEMY OF ACTUARIES

Note: All page numbers refer to the bill itself.

1. p. 21, l. 10 Change first "plan" to "fund" and delete second "of the plan".
2. p. 21, l. 12 Delete "and" and substitute in its place "of the fund and related".
3. p. 21, l. 20 Change "plan" to "fund".
4. p. 22, l. 1–2 Delete "therein when . . . as a whole" and substitute in its place "in the annual report".
5. p. 22, l. 12 Add two new sentences after "actuary" as follows: "The opinion of the accountant under this section is limited to the status and operations in respect to the assets of the fund and excludes actuarial matters certified to by the enrolled actuary. 'Actuarial matters' may be further defined by regulation by the Administration and shall include the items required to be included in the actuarial statement under subsection (d) of this section."
6. p. 24, l. 5 Delete "liabilities" and substitute in its place "non-actuarial liabilities of the fund".
7. p. 25, l. 2 Change "plan" to "fund".
8. p. 25, l. 6 Insert before "liabilities" the word "non-actuarial".
9. p. 25, l. 7 Change "plan" to "fund".

STATEMENT OF STEPHEN G. KELLISON, EXECUTIVE DIRECTOR, AMERICAN ACADEMY OF ACTUARIES, WASHINGTON, D.C.

Mr. KELLISON. My name is Steve Kellison. Our president, Mr. Gustafson, is in Milwaukee. He had a meeting this morning and he was planning to drive down this afternoon. He may or may not walk in the door at any moment.

The American Academy of Actuaries is pleased to submit these comments on H.R. 14138, the Public Employee Retirement Income Security Act of 1978. The academy is vitally interested in this bill, since the large majority of actuaries performing actuarial services for State and local public employee retirement systems are members of the academy. Appendix A contains some background information about the academy.

H.R. 14138 is a very comprehensive bill which has a number of provisions that would affect the work of actuaries in connection with State and local public employee retirement systems. However we would prefer to comment today on only one aspect of the bill; namely, the relationship between actuaries and accountants under the bill. We would like to study the bill more thoroughly and defer any comments

on other aspects of the bill until hearings which we anticipate will be held in 1979.

The relationship between actuaries and accountants under the Employee Retirement Income Security Act of 1974 is important background to consider, since the general framework of PERISA is analogous to that contained in ERISA in this connection. However, despite the similarity between the two, PERISA contains some fundamental differences from ERISA which will be discussed later in section III of this statement.

Section 103 of ERISA appears to create a division of responsibility between actuaries and accountants. The actuary's report is concerned with such items as the determination of present values for future benefit payments and the various computations required to determine whether the plan complies with minimum funding requirements. The accountant's report is concerned with a proper presentation of the financial status of the pension fund itself.

Despite this apparently clear division of responsibility contemplated by ERISA, some differences of opinion have arisen between actuaries and accountants concerning their relative roles under the act. One major area of difference has involved the wishes of the accounting profession to include actuarial present values in the financial statements of the plan.

ERISA does not require or even imply that this was the intent; in fact, there is considerable evidence that Congress intended that such actuarial values not be included in the financial statements of the plan. Current proposals of the accounting profession to include actuarial values in the financial statements rests solely on the broad discretion given the accounting profession to define "generally accepted accounting principles."

The dialogue on this issue has recently been focused on the exposure draft of the Financial Accounting Standards Board issues in April 1977 which attempts to define generally accepted accounting principles for pension plans. That exposure draft, if implemented without change, would lead to the reporting of two sets of actuarial present value figures which are likely to differ substantially, one by the accountant in the plan's financial statements and the other by the actuary in the required actuarial statement. This unfortunate result would produce considerable confusion among plan participants, plan sponsors, and other interested parties.

The academy believes that requiring actuarial present values to appear in the financial statements of the plan is both unnecessary and confusing, and that section 103 of ERISA only requires the accountant's report to be concerned with the pension fund itself. However, the FASB has a responsibility for defining generally accepted accounting principles and we recognize that some type of actuarial present value figures may be required by the FASB to appear in the financial statements of the plan. Accordingly, the Academy has participated in extensive discussions with the FASB and the U.S. Department of Labor in attempting to arrive at a mutually acceptable method of determining the present value of accrued benefits for this purpose, if in fact it is to be included. Considerable progress has been made in this endeavor, although a couple of knotty problems yet remain to be resolved. It is

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important to stress again that the actuary's report will include actuarial present values for funding purposes which are substantially different from this value which may be required for the financial statements of the plan.

A second unresolved problem area has arisen in the auditing area. Section 103 of ERISA provides that the accountant may rely on the correctness of any actuarial matter certified to by an enrolled actuary, if he so states his reliance and conversely, that actuaries may rely on the work product of qualified accountants in an analogous manner. However this provision has never become operational in the manner Congress intended.

This results from audit guidelines, which predate ERISA, of the American Institute of Certified Public Accountants to the effect that any opinion of an auditor which expresses reliance on the work of others becomes a "qualified opinion," with all the resulting negative connotations attached to that term. The AICPA has not changed this position, despite the statutory authority for such an expression of reliance contained in ERISA, although the matter is currently under study.

Section 103 of PERISA is quite analogous to section 103 of ERISA in dealing with the relationship between actuaries and accountants with two notable exceptions:

One, section 103(a)(3)(B) provides that the accountant shall rely on the correctness of any actuarial matter certified to by an enrolled actuary. Likewise, section 103(a)(4)(C) provides for similar reliance by actuaries on accountants. Thus, PERISA changes the voluntary reliance of ERISA to compulsory reliance.

Two, section 103(a)(3)(A) of ERISA indicates that audits shall be conducted in accordance with "generally accepted auditing standards." Section 103(a)(3)(A) of PERISA contains the same wording, with the important addition that the reliance provisions described above are specifically authorized, even though departing from generally accepted auditing standards as presently defined by the AICPA.

The academy strongly endorses these two provisions contained in PERISA. We believe that they would be quite beneficial in resolving the difficulties which have arisen under ERISA, as described in section II of this statement.

In addition there are a few other amendments which could be made to further clarify the relative roles of the two professions. These amendments are consistent with the intent of H.R. 14138 and are submitted for the consideration of the committee in appendix B.

We would also like to call attention to S. 3017, the Williams-Javits bill, which is an omnibus ERISA-revision measure that was also introduced in 1978. S. 3017 contains proposed changes to ERISA which would make the two changes described above in section III of this statement. Thus, on the issue of the relationship between the actuarial and accounting professions there is consistency between S. 3017 and H.R. 14138.

The academy testified in favor of this portion of S. 3017 at a public hearing held on August 17, 1978. Amendments similar to those contained in appendix B were also recommended for adoption into S. 3017. We would urge that provisions similar to those contained in H.R. 14138

and S. 3017 be incorporated in any ERISA-revision bills developed in the House of Representatives in the next session of the Congress.

In summary, the academy strongly supports the provisions of H.R. 14138 concerning the relationship between actuaries and accountants. We would also like to recommend additional amendments which are consistent with the intent of the bill to further clarify this relationship. Finally, we wish to defer until a later date any comments on other aspects of the bill.

Mr. SIMON. Thank you very much.

I notice on ERISA you and the accountants are getting together. Is there a possibility that the two groups could also get together on a bill like this before it becomes law?

Mr. KELLISON. I mentioned two areas here. One was the inclusion of actuarial present values in a plan's financial statements. Several groups have been involved, including the AICPA and FASB and the Department of Labor, as well as the academy. They have spent an enormous amount of time and considerable progress is being made. I have heard that as a result of an FASB meeting last Thursday the area of differences narrowed considerably. I think it was decided not to require that accrued benefits be based on future salary projections. This was a major area of difference and will go a long way toward resolving this particular issue.

On the question of reliance, the AICPA has appointed a special task force to review Statement of Auditing Standards No. 11, commonly referred to as SAS 11, which concerns using the work of a specialist. This is an area that I think is of concern here. The accountant's usage of the work of an actuary, basically the way they approach the problem, is to look upon actuaries as specialists in connection with auditing procedures. The AICPA, as I said, has appointed a task force working in the area of SAS 11. They have invited the academy to appoint a corresponding task force, which we have done. That group has been operational since August and has met at least once, maybe twice, on this reliance question with the AICPA, and will continue to meet with them over the next several months.

Mr. SIMON. Mr. Erlenborn.

Mr. ERLENBORN. Thank you for your presentation.

I don't have any questions.

Mr. SIMON. Thank you very much.

We thank all of you people.

This concludes our hearing.

[Whereupon, at 1:50 p.m., the subcommittee adjourned, to reconvene at the call of the Chair.]

APPENDIX

THE NEW YORK TEACHERS PENSION ASSOCIATION, INC.,
New York, N.Y., November 11, 1978.

Hon. JOHN DENT,
House of Representatives,
Cannon Office Building, Washington, D.C.

DEAR REPRESENTATIVE DENT: We wish to appear at hearings held in Washington on H.R. 14138.

We enclose a statement for the record.

Sincerely yours,

WILLIAM WITHERS, Ph.D., *President.*

STATEMENT OF DR. WILLIAM WITHERS, PRESIDENT, NEW YORK TEACHERS PENSION ASSOCIATION

The New York Teachers Pension Association, consisting of retirees of the New York City colleges, high schools and elementary schools, strongly objects to the omission in H.R. 14138 of provisions contained in ERISA (Employee Retirement Income Security Act of 1974) which regulate the funding of pension plans and arrange for the insurance of pensions under the Pension Benefit Guaranty Corporation. As it now stands, the bill does not provide the kind of protection most essential for the security of public pensioners.

Not only in New York City, but in many other localities, public pension systems are seriously underfunded. Also, over 80 percent of all public pension systems are contributory. If the money public pensioners have contributed had been put into savings banks, it would not only be safely invested, but have FDIC protection. Why are public pensioners not entitled to similar protection?

It is often asserted that they are protected by prior claims on state and local taxation. This is not true. If local governments become bankrupt, police and fire protection have priority. In New York City, for example, city pensioners supposedly are protected by a section in the state constitution which states that municipal pension contracts cannot be impaired. It merely guarantees the pension contract, not the payment of the pensions. In New York City there is a law which makes the city responsible for payment of pensions, but only after "essential services" are taken care of.

Over a third of New York City pensioners receive pensions of less than $4,000 a year. Most of these low income pensioners also have no social security. This low income group also contributed half of the money for their pensions themselves! If their money had been deposited in savings banks, it would have FDIC protection. Certainly these poor pensioners deserve the insurance and funding protections of ERISA.

STATE UNIVERSITIES RETIREMENT SYSTEM (ILLINOIS)

STATEMENT IN OPPOSITION TO H.R. 14138

Mr. Chairman, Members of the Subcommittee on Labor Standards, Pension Task Force, House Committee on Education and Labor:

My name is Edward S. Gibala. I have been the Executive Director of the State Universities Retirement System (Illinois) for the past 27 years, during which time I have observed the strengths and weaknesses of public employee pension plans in the United States. I have served as Chairman of the Committee on Public Employee Retirement Administration, Municipal Finance Officers Association of the United States and Canada and have been a member of the National Conference on Teacher Retirement for many years. I wish to record my strong opposition to H.R. 14138, which is entitled the Public Employee Retirement Income Security Act of 1978. The title is a misnomer.

This legislation would create the same mountain of paperwork for public employee pension plans which Congress foisted upon private plans when it passed

the private Employee Retirement Income Security Act of 1974, but it would fail to correct any of the serious problems which public pension plans have encountered in the past.

The legislation would do absolutely nothing for the participants of public pension plans. The Bill neglects to address the question of funding, which is by far the most serious problem facing participants of public pension plans. The Bill would continue to allow discrimination in favor of members of the state legislatures, judges and other higher paid officials. The Bill does not establish any minimum vesting or participation standards to protect the rights of public employees. It does nothing to justify its title of Public Employee Retirement Income Security Act, because it provides little or no security for public employees.

The private Employee Retirement Income Security Act of 1974 created a mountain of paperwork for private pension plans, but this additional expense could be justified because that legislation set funding, vesting, participation and other standards which provided a great deal of security for private employees. On the other hand, the proposed Public Employee Retirement Income Security Act of 1978 would not correct any of the evils or provide any additional security for public employees which would justify the additional expense of the detailed reporting which would be required.

If the Committee on Education and Labor recommends approval of H.R. 14138, it should revise the time period during which the detailed annual report with actuarial data etc. is to be filed with the Federal Employee Benefit Administration. Public pension plans which cover several hundred units of government generally could not meet the 210 day deadline on filing of the reports. Those systems which account for funds on an accrual basis must wait for final payroll reports from all units of government before closing their books and compiling statistical data for the actuary. The final report for the year may disclose hundreds of cases in which employee contributions have been received, but the units of government have failed to provide information concerning date of birth, marital status and other data which is required before accurate actuarial estimates may be made. The deadline of filing of the annual reports should be extended to at least 365 days; otherwise, retirement system administrators will be subject to penalties for late filing which is caused by circumstances which are beyond their control.

The Committee should also revise the section of the Act which requires that the administrator engage an independent qualified public accountant to audit the records of the retirement system. In Illinois, the Auditor General has the responsibility for appointment of the independent public accounts, and the Trustees of the retirement system cannot select the auditors. The Federal government should not require that the administrator duplicate a function which the state legislature has assigned to some other state official.

Why does the Act require that the detailed investment schedule in the annual report show the cost of each security which is purchased? Does this mean initial cost or amortized cost? This requirement would add considerably to the cost of preparing this report, because the detailed periodic investment reports which are compiled by banks generally omit the amortized cost figures and a report which fails to show amortized cost would be meaningless.

Why is it necessary for a public retirement system to submit to the Federal government an explanation of the reason for any change in appointment of consultants, brokers, trustees, attorneys, accountants, insurance carrier, actuary, administrator, investment manager or custodian? The Act does not give the Federal government control over the selection of such personnel, so why require that the trustees provide an explanation of the reason for any change in such personnel.

The Bill requires that the public system provide information concerning the number of participants who are eligible for a deferred vested pension benefit. It would be impossible for most public pension plans to provide accurate data concerning the number who have a vested benefit, because eligibility generally must be based upon the provisions of the pension law which were in effect on the date employment terminated. A person who terminated employment in 1977 may have a vested interest if he had 5 years of service credits while a person who terminated employment in 1948 could not qualify even though he may have had 20 or more years of service at termination. This provision of the Act would require that the staff of the State Universities Retirement System examine about 40,000 records manually to provide the required data on vesting, a task which would be

literally impossible without a tremendous increase in the number of staff members.

In view of the tremendous increase in administrative costs which the detailed reporting requirements would entail and the failure of H.R. 14138 to correct the funding problem or to set minimum standards for vesting and participation which would be required to protect the pension rights of public employees, I urge that the Subcommittee on Labor Standards recommend disapproval of this Federal legislation.

EDWARD S. GIBALA, *Executive Director.*

PREPARED STATEMENT OF MICHAEL L. MORY, EXECUTIVE SECRETARY, STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

My name is Michael Mory, I am Executive Secretary of the State Employees' Retirement System of Illinois. Our system administers a comprehensive benefit program for approximately 107,000 active and inactive State employees and over 22,000 benefit recipients. Prior to 1975 I was the head of the Public Employee Pension Fund division of the Illinois Department of Insurance, an agency which operates in a regulatory capacity over nearly 500 local fire and police funds in the State.

In responding to the issue of federal regulation of public employee pension funds, I must endorse completely comments made to the committee by Senator Egan. While certain abuses and inadequacies most certainly exist in the public plan universe, particularly in situations involving small membership funds, I am confident, based on our own system, as well as relationships with administrators of many other State wide programs that basic inadequacies detrimental to fund participants as addressed by HR 14138 do not exist to any measurable degree. To the contrary, I believe a great majority of the larger have, for some time, adequately addressed the issues which prompted introduction of this legislation, particularly in the areas of disclosure to plan participants and financial reporting. Also, it is interesting to note that this legislative proposal again fails to address the greatest problem facing public funds, that of inadequate financing. As a result, while systems such as ours could conform to the requirements contained in this legislation by alteration of existing systems and procedures, any level of additional expense incurred, particularly in regard to filing numerous reports with the Federal Government, would appear unjustified.

Recognizing however, that the primary purpose of this hearing is to solicit specific comments on provisions contained in HR 14138 I have attempted to analyze the effect of this legislative proposal although admittedly, on a preliminary basis due to the short period of time between its introduction and this hearing. I would, therefore, apologize to members of the Committee for any misinterpretation I may have made regarding provisions contained in this bill.

In the area of disclosure to fund participants, specifically, the distribution of the Summary Plan Description, while we currently provide and update this type of information every two years, updated publications are not routinely distributed to inactive fund participants and benefit recipients. In Illinois, contrary to private sector plan design concepts, State statute provides that plan amendments shall not apply to an individual unless he or she is in service on the effective date of the amendment. As a result, distribution of current plan description material to inactive participants and benefit recipients, would in most instances result in a misstatement of an individual's rights and benefits under the plan. To attempt to even footnote or reference the effective date of change of every benefit provision would be, in our opinion, impractical in any single plan description brochure as many provisions have been amended several times during the past several years. This situation appears to be a problem in HR 14138 as we would apparently be required initially to distribute the Summary Plan Description to all inactive members and individuals currently receiving benefits from the System. This problem would also appear to exist in the case of a future beneficiary of an inactive or retired member whose benefits would be based on plan provisions in effect at the date of the member's withdrawal from service instead of date of death. I would suggest that our current procedure of providing plan description material to all new members and updating this information every two years to all active members, as well as distribution of legislative update information yearly, to active members and benefit recipients, if applicable, better provides our membership

with accurate information regarding their individual rights and benefits. I would also point out in regard to inactive members that it is almost impossible to maintain up to date address information. While we have attempted to obtain this information from agencies of both federal and state government, laws pertaining to confidentiality of information have resulted in failure of such efforts.

In reference to the accrued benefit statement required by HR 14138, while our System has since it was established provided active and inactive members annually with a statement which discloses their total creditable service, contributions and interest in the System, we have not attempted to provide a benefit estimate on either an accrued or projected basis as part of the annual statement due to the general nature of assumptions which would have to be made to provide this information on a mass basis. Rather, we encourage members to request benefit estimates which are provided on a projected basis in accordance with the expected date of retirement provided by the member. Except in the case of a terminated vested employee, I can see little value in providing an accrued benefit statement to an employee who is in service and where plan benefits are based on a final pay formula. Individuals desiring such information generally are attempting to estimate their finances after retirement based on an assumed retirement date and continuance of their present employment. We believe this provision of the Act should be generalized to specify that benefit estimates may be provided on either an accrued or projected basis in accordance with the request of the participant. In addition, since Illinois provides for portability between the various public systems in the State, thus requiring certification of service credits to provide benefit estimates, we believe that the 30 day requirement must be liberalized to not less than 60 days. While we could certainly meet the 30 day requirement if we were to ignore service in another system benefit estimates provided could be significantly understated.

While our Actuary has, for many years, prepared Valuation Reports on an annual basis and conducted an experience analysis at no greater than 5 year intervals, we are concerned over the possibility that the power vested in the Employee Benefits Administration as contained in H.R. 14138 may result in the need to prepare two separate actuarial reports, one to comply with PERISA, the other for funding purposes. While the proposed legislation acknowledges this fact, in a government environment where appropriations for funding purposes must be made, in our case by the State Legislature, I am fearful that contradictory actuarial information may greatly hamper our efforts to secure adequate financing. This problem relates to the independent structure of public pension funds as opposed to the controlled nature of a pension program operating in a corporate environment. As a result, I would strongly recommend that any legislation in this area only specify the time period between actuarial reviews and the requirement that explicit best estimate assumptions be utilized. All other factors or assumptions utilized in the actuarial report, such as, asset valuation should be left to the judgment of the Actuary based on the experience of each particular fund.

While I believe the drafters of H.R. 14138 have attempted to recognize the unique characteristics of public funds in setting forth fiduciary standards, due to the method of operation of our investment function, I am still not totally satisfied that the liability of our trustees has been adequately defined.

Our plan document, which is in the form of a State statute, was amended in 1969 to remove the investment function from our Board of Trustees and transfer it to another State agency known as the Illinois State Board of Investment. The investment board was structured to handle the investment function for all public plans in the State but as of this time only has 3 systems under its jurisdiction. The investment board is directed by a separate board of trustees mandated by State law, one of which is the Chairman of our Board of Trustees. Since our Board, by law, has no control over the investment function, other than the single vote of our board chairman, I am concerned that some degree of liability may still be placed on our trustees even though they have no legal control over the operations of the State Investment Board. Also, our board chairman is, by statute, a public member appointed by the Governor who serves on a voluntary basis without compensation. Quite frankly, I cannot imagine a business man volunteering his time if he could be subjecting himself to financial liability. I would, therefore, also suggest that the concept of passing liability to the employer should be clearly applied to a member of the public who serves in a trustee capacity as is proposed in the case of an employee or public official.

Finally, I am somewhat confused over the need for the bonding requirement

contained in Section 212 after considering categories specifically excluded in this section and the concept of passing liability to the employer.

In conclusion, with increasing pressures on all levels of government, including the federal government, to hold down or even reduce existing spending levels we do not believe that costs associated with implementation of HR 14138 can be justified based on the benefits which can reasonably be expected. We would suggest, if justifiable at all, that this legislative effort should be better targeted toward the small membership funds where personal experience has shown me that the great majority of the problems exist. In any event, with inflation again out of control, due partially to excessive spending by the federal government, the addition of another regulatory function at this time must be seriously questioned.

PREPARED STATEMENT OF ROY A. BAKER, DIRECTOR; TEACHERS' RETIREMENT SYSTEM, STATE OF ILLINOIS, SPRINGFIELD, ILL.

My name is Roy A. Baker and I am Director of the Teachers' Retirement System of the State of Illinois.

Our System services 105 thousand active members, 30 thousand inactive members, and approximately 32 thousand annuitants. The System is an agency of State government and is controlled by a Board of Trustees whose authority is set forth in Chapter 108½, Article 16, of the Illinois Revised Statutes.

Our fund has an annual valuation, and an experience analysis every four years. The System has three full-time internal auditors, and by statute is audited annually by qualified, outside auditors under the direction of and paid by the State of Illinois. With few exceptions, our reporting and disclosure go beyond the provisions outlined in H.R. 14138.

I realize the purpose of this meeting is to afford everyone who desires the opportunity for input in H.R. 14138. And, although I feel there is no need for the provisions of H.R. 14138 in a System such as ours, I shall, nevertheless, state some positive points of the proposal:

1. The fact that public plans such as ours would automatically be deemed as "qualified" plans by IRS is to be commended. Although we are a qualified plan, it is necessary we renew this qualification each time the Legislature changes a provision of our program.

2. The creation of a single agency at the Federal level, namely the "Employee Benefit Administration" is also commendable. Even without the provisions of H.R. 14138, there would benefit to all funds to have such an agency at the Federal level.

3. Disclosure to plan participants is an absolute necessity, and I commend most of the provisions along this line which are incorporated in H.R. 14138.

4. As to the reporting aspect of this bill, hopefully, there would not be a duplication of reports either at the State or Federal level. Our System already completes IRS Form-5500; we issue an annual financial report; and we make a statistical report to the State of Illinois Department of Insurance. Our annual financial report is available to all members of the System, and to other interested parties.

The negative aspects of H.R. 14138 in the area of disclosure are:

1. Since we deal with multiple employers (1,200 school districts), disclosure at the end of the fiscal year in 210 days may be impossible, if the disclosure is to be audited externally.

2. Very little could be gained by furnishing an inactive participant of the System benefit calculations, other than at the time of termination, or information about additional legislation which may not pertain to his rights and benefits.

3. The area in which the Teachers' Retirement System of the State of Illinois could definitely stand to benefit would be a requirement for an acceptable funding level. As you well know, H.R. 14138 does not address itself to this problem.

4. From past history, we can assume there will be additional expenditures in complying with provisions of H.R. 14138. Since this comes at a time when most of us in the public sector are trying to hold the line on costs for administration of public services, we question its advisability.

Since our Fund is governed by an unpaid Board of Trustees, I would strongly suggest that the liability for any non-fraud action be assumed by the employer and not by the individual trustees.

I do appreciate this opportunity to respond at this public hearing on H.R. 14138.

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