Guaranty Fund for Private Pension Obligations

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Introduction to the Appendices

The purpose of these appendices is to trace the development of the pension guaranty concept in the United States as revealed through the basic legislative proposals, testimony presented before congressional committees, and significant statements in private publications. The materials are reproduced herein in approximate chronological sequence.

The earliest formal pronouncement on the subject was contained in the Provisional Report of the President's Committee on Corporate Pension Funds, submitted to President Kennedy in late 1962. The Committee called attention to the lack of assurance that a terminating pension plan would have sufficient assets to cover its accrued benefit obligations. It recommended that serious study be given to "a system of insurance which, in the event of certain types of termination, would assure plan participants credit for accrued benefits." This recommendation survived a review of the Provisional Report by the President's Committee on Labor-Management Policy and appeared in the final report that was released in January, 1965. The source of the recommendation seems to have been the United Automobile Workers, which had had experience with plan terminations that resulted in loss of accrued benefits and was on record as favoring some type of guaranty mechanism.

The first legislative proposal on the matter was S. 3071, introduced on August 3, 1964, by Senator Vance Hartke of

Indiana, after termination of the Studebaker plan. As a first effort at formulating a complex program, the bill was understandably drawn in very general terms and failed to come to grips with many of the technical problems that would be encountered in such an undertaking. It proposed to provide protection against loss of pension benefits not only from a general inadequacy of accumulated assets but also from shrinkage of assets occasioned by the forced sale of investments to pay benefits. No hearings were held on the bill, and it died in committee. Despite its imperfections, the bill was significant as the first of its kind and is reproduced here as Appendix A.

A month after the appearance of the Hartke Bill, Representative J. Ernest Wharton of New York introduced a bill, H.R. 12566, that would have restricted the investments of a pension plan funded through the medium of a trust to (1) those authorized for corporate and individual fiduciaries in the state in which the principal office of the state is located or (2) those the payment of which would be insured or otherwise guaranteed by a person licensed to engage in an insurance, guaranty, or surety business. This bill was never acted upon by Congress and has not been reintroduced since that time.

On the other hand, Senator Hartke reintroduced his bill, with minor modifications, in the first session of the 89th Congress on March 18, 1965, and it was assigned the designation S. 1575. Hearings were held on this bill on August 15, 1966—about 17 months later—and Appendix B sets out some of the more significant statements presented before the Senate Finance Committee. These statements are instructive in that they represent the initial reaction of various groups, both inside and outside the government, to the notion of a federal scheme for insuring pension benefits.

Appendix C reproduces a paper presented to the Chicago Actuaries Club on April 19, 1965, by Howard Young, actuarial consultant to UAW. This paper outlines the features of S. 1575 and analyzes some of the technical problems involved in a pension "reinsurance" program. This paper was printed in the September 28, 1965, issue of the *Congressional Record* at the request and approbation of Senator Hartke.

After the publication of the Report of the President's Committee on Corporate Pension Funds in January, 1965, and the introduction of the second Hartke Bill, there was considerable discussion within pension professional groups of the reinsurance proposal. The general reaction was that the program was not technically feasible; these groups were especially critical of the feature that would insure against losses attributable to forced liquidation of plan assets and the general lack of safeguards against adverse selection. These criticisms were reflected in the next version of the Hartke Bill, S. 1635, introduced during the first session of the 90th Congress on April 26, 1967. In this bill Senator Hartke modified his earlier proposals by (1) eliminating the provision dealing with asset losses, (2) making participation in the program mandatory, and (3) granting authority to the Secretary of HEW to discontinue protection of the program for a plan that in the judgment of the Secretary had been established with the expectation that termination would occur within five years. No hearings were held on this bill, reproduced here as Appendix D, and no congressional action was taken.

In the meantime, Senator Javits of New York and his staff had been monitoring the debate over private pension plans that erupted after publication of the Report of the President's Committee on Corporate Pension Funds. On February 28, 1967, Senator Javits introduced a bill, S. 1103, which he described as "the first truly comprehensive legislative proposal to deal with the major problems and defects in our private pension plan system." The bill, an expanded version of an earlier bill (S. 2352), would have established minimum standards of vesting and funding, a central portability fund, minimum standards of conduct for plan administrators, *a program of pension plan reinsurance,* and an independent federal commission to administer and enforce the provisions of the bill. Senator Javits' bill was patterned closely after the Hartke Bills, especially the third one introduced two months after the Javits' Bill). Its principal significance was found in the fact that it was the first legislative measure to recognize that a program of plan termination would not work unless it was bulwarked by minimum standards of vesting and funding, as well as other safeguards. The bill required that an employee's benefits vest in full after 15 years of service and the attainment of age 45, or alternatively, vest to the extent of one half after 10 years of service, grading up to 100 percent vesting after 20 years. The funding standard contemplated current funding of normal cost and amortization of unfunded liabilities over a 30-year period (40-year period under existing plans). Despite the formulation of minimum vesting and funding standards, the bill did not lock the reinsurance provisions into those standards, as was done by the Department of Labor bill a year later.

The Javits' Bill was reintroduced in modified form, as S. 2167, in the 1st Session of the 91st Congress, on May 14, 1969. Several companion bills were introduced in the House of Representatives at about the same time. The reinsurance proposal remained substantially unchanged. No hearings have been held on either of the two Javits' Bills, although hearings on other bills have touched upon matters covered by the Javits' Bills, including the reinsurance proposal. Appendix E sets out the reinsurance feature of the original Javits' Bill, along with the relevant comments of Senator Javits at the time he introduced the legislation.

Following release of the Report of the President's Committee on Corporate Pension Funds, an Interagency Staff Committee was established to study ways and means of implementing the recommendations. The Committee deliberated over a three-year period and consulted with many knowledgeable persons in the pension field. Its work culminated in a very comprehensive legislative proposal introduced into the Senate on May 2, 1968, by Senator Ralph W. Yarborough of Texas as S. 3421 and into the House on May 6, 1968, by Carl D. Perkins of Kentucky as H.R. 17046. This legislation would have required vesting after 10 years of continuous service, subject to various transitional exceptions, and funding of all accrued benefits over a 25-year period. These standards would have become an integral part of a plan termination insurance program. The insurance proposal was the most sophisticated one that has yet been placed before Congress and reflected careful consideration of the many technical problems that would have to be surmounted. The insurance proposal, reproduced herein as Appendix F, did not contemplate the insuring of pension plan assets against investment or forced liquidation losses. Hearings on the legislation were held in the Senate on July 25, 1968, at which time Assistant Secretary of Labor, Thomas R. Donohue, presented testimony relevant portions of which are reprinted here as part of Appendix F. Because of the change in administrations, the bill was not reintroduced as a Labor Department measure in the 91st Congress. Nevertheless, the substantive features of the PBSA were included in six identical bills introduced in the House, the best known of which is H.R. 1045, introduced January 3, 1969, by Congressman John H. Dent of Pennsylvania (there was no companion bill in the Senate). Hearings were held on the Dent Bill on December 10, 1969, and on various days in the spring of 1970. Testimony on plan termination protection by two witnesses is included herein as Appendix G.

On February 26, 1970, Senator Hartke introduced his reinsurance bill for the fourth time. This version of the bill, S. 3517, restored the provision that would insure against losses caused by forced liquidation of assets and raised the amount of benefits insured in respect of one individual from 50 to 80 percent of his highest average monthly wage in the five-year period for which his earnings were the greatest, subject to a limit of $500 per month in benefits. This bill is still in relatively rudimentary form and is not likely to receive serious legislative consideration.

The final appendix sets out the section on "Reinsurance" in the monograph, *Private Pension Plans and the Public Interest,* prepared by the Committee on Employee Benefits of the Financial Executives Institute in response to various legislative proposals aimed at private pension plans.

Appendix A

S. 3071. Federal Reinsurance of Private Pension Plans Act

*Introduced by Senator Vance Hartke**

A BILL

To establish a self-supporting Federal reinsurance program to protect employees in the enjoyment of certain rights under private pension plans.

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

SHORT TITLE

SECTION 1. This Act may be cited as the "Federal Reinsurance of Private Pension Plans Act."

DEFINITIONS

SEC. 2. As used in this Act—

a) The term "pension fund" means a trust, pension plan, or other program under which an employer undertakes to provide, or assist in providing, retirement benefits for the exclusive benefit of his employees or their beneficiaries. Such term does not include any plan or program established by a self-employed individual for his own benefit or for the benefit of his survivors or established by one or more owner-employees exclusively for his or their benefit, or for the benefit of his or their survivors.

* Introduced August 3, 1964, 88th Cong., 2d sess. This bill constituted the first attempt to establish by federal legislation a mechanism for protecting pension plan participants against loss of accrued benefits through termination of the plan.

b) The term "eligible pension fund" means a pension fund which meets the requirements set forth in section 401 of the Internal Revenue Code of 1954 with respect to qualified pension plans.

c) (1) The term "insured pension fund" means an eligible pension fund which has been in operation for not less than three years and, for each of such years, has met the requirements set forth in subsection (*b*) and has been insured under the program established under this Act.

(2) Any addition to, or amendment of, an insured pension fund shall, if such addition or amendment involves a significant increase (as determined by the Secretary) in the unfunded liability of such pension fund, be regarded as a new and distinct pension fund which can become an "insured pension fund" only upon compliance with the provisions of paragraph (1) of this subsection.

ESTABLISHMENT OF INSURANCE PROGRAM

SEC. 3. There is hereby established in the Department of Health, Education, and Welfare a program to be known as the Federal insurance program for private pension plans (hereinafter referred to as the "program"). The program shall be administered by, or under the direction and control of, the Secretary.

CONTINGENCIES INSURED AGAINST UNDER PROGRAM

SEC. 4. *a*) The program shall insure (to the extent provided in subsection [*b*]) beneficiaries of an insured pension fund against loss of benefits to which they are entitled under such pension fund arising from—

(1) failure of the amounts contributed to such fund to provide benefits anticipated at the time such fund was established, if such failure is attributable to cessation of one or more of the operations carried on by him in one or more facilities of such employer; or

(2) losses realized upon the sale of investments of such fund if the sale is required to provide benefits payable by such fund.

b) The rights of beneficiaries of an insured pension fund shall only be insured under the program to the extent that such rights do not exceed—

(1) in the case of a right to a monthly retirement or disability benefit for the employee himself, the lesser of 50 per centum of his average monthly wage in the five-year period for which his earnings were the greatest or $500 per month;

(2) in the case of a right on the part of one or more dependents, or members of the family of, the employee or in the case of a right to a lump-sum survivor benefit on account of the death of an employee, an amount found by the Secretary to be reasonably related to the amount determined under subparagraph (1).

In the case of a periodic benefit which is paid on other than a monthly basis, the monthly equivalent of such benefit shall be regarded as the amount of the monthly benefit for purposes of clauses (1) and (2) of the preceding sentence.

c) If an eligible pension fund has not been insured under the program for each of at least the three years preceding the time when there occurs the contingency insured against, the rights of beneficiaries shall not be insured and in lieu thereof the contributions made on behalf of such pension fund during such period shall be returned to the pension fund.

PREMIUM FOR PARTICIPATION IN PROGRAM

SEC. 5. *a*) Each eligible pension fund may, upon application therefor, obtain insurance under the program upon payment of such annual premium as may be established by the Secretary. The Secretary shall establish separate premium rates for insurance against each of the contingencies described in section 4 (*a*) (1) and section 4 (*a*) (2). Each such premium rate shall be uniform for all pension funds insured by the program and shall be applied to the amount of the unfunded obligations and assets, respectively, of each insured pension fund. The premium rates may be changed from year to year by the Secretary, when the Secretary determines changes to be necessary or desirable to give effect to the purposes of this Act; but in no event shall the premium rate established for the contingency described in section 4 (*a*) (1) exceed $1 per dollar of unfunded obligations, nor shall the premium rate established for the contingency described in section 4 (*a*) (2) exceed 25 cents per dollar of assets.

b) The Secretary, in determining premium rates, and in establishing formulas for determining unfunded obligations and assets of pension funds, shall consult with, and be guided by the advice of, the Advisory Council (established by section 8).

c) If the Secretary (after consulting with the Advisory Council) determines that, because of the limitation on rate of premium established under subsection (*a*) or for other reasons, it is not feasible to insure against loss of rights of all beneficiaries of insured pension funds, then the Secretary shall insure the rights of beneficiaries in accordance with the following order of priorities—

(1) First: individuals who, at the time when there occurs the contingency insured against, are receiving benefits under the pension fund, and individuals who have attained normal retirement age and who are eligible, upon retirement, for retirement benefits under the pension fund;

(2) Second: individuals who, at such time, have attained the age for early retirement and who are entitled, upon early retirement, to early retirement benefits under the pension fund; or, if the pension fund plan does not provide for early retirement, individuals who, at such time, have attained age sixty and who, under such pension fund, are eligible for benefits upon retirement;

(3) Third: individuals who, at such time, have attained age forty-five;

(4) Fourth: individuals who, at such time, have attained age forty; and

(5) Fifth: in addition to individuals described in the above priorities, such other individuals as the Secretary, after consulting with the Advisory Council, shall prescribe.

d) Participation in the program by a pension fund shall be terminated by the Secretary upon failure, after such reasonable period as the Secretary shall prescribe, of such pension fund to make payment of premiums due for participation in the program. Participation by any pension fund in the program may be terminated by such fund at any time by giving not less than sixty days' notice of termination to the Secretary.

REVOLVING FUND

SEC. 6. *a*) In carrying out his duties under this Act, the Secretary shall establish a revolving fund into which all amounts paid into the program as premiums shall be deposited and from which all liabilities incurred under the program shall be paid.

b) The Secretary is authorized to borrow from the Treasury such amounts as may be necessary, for deposit into the revolving fund, to meet the liabilities of the program. Moneys borrowed from the Treasury shall bear a rate of interest determined by the Secretary of the Treasury to be equal to the average rate on outstanding marketable obligations of the United States as of the period such moneys are borrowed. Such moneys shall be repaid by the Secretary from premiums paid into the revolving fund.

c) Moneys in the revolving fund not required for current operations shall be invested in obligations of, or guaranteed as to principal and interest by, the United States.

AMENDMENT TO INTERNAL REVENUE CODE

SEC. 7. *a*) Section 404 of the Internal Revenue Code of 1954 (relating to deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan) is amended by adding at the end thereof the following new subsection:

> (g) GENERAL LIMITATION.—Notwithstanding the preceding provisions of this section, no employer shall be entitled, with respect to any taxable year, to a deduction under this section on account of contributions to a pension fund which is, during all of such taxable year, an 'eligible pension fund' within the meaning of the Federal Reinsurance of Private Pension Plans Act unless, at the close of such taxable year, such pension fund was insured under the program established by such Act.

b) The amendment made by subsection (a) shall be effective with respect to taxable years which begin not less than six months after the date of enactment of this Act.

ADVISORY COUNCIL

SEC. 8. *a*) There is hereby created a Federal Advisory Council for Insurance of Employees' Pension Funds (hereinafter referred to as the "Advisory Council"), which shall consist of nine members, to be appointed by the President, by and with the advice and consent of the Senate. The President shall select, for appointment to the Council, individuals who are, by reason of training or experience, or both, familiar with and competent to deal with, problems involving employees pension funds and problems relating to the insurance of such funds. Members of the Council shall be appointed for a term of two years.

b) Members shall be compensated at the rate of $100 per day for each day they are engaged in the duties of the Advisory Council and shall be entitled to reimbursement for traveling expenses incurred in attendance at meetings of the Council. The Advisory Council shall meet at Washington, District of Columbia, upon call of the Secretary who shall serve as Chairman of the Council. Meetings shall be called by such Chairman not less often than twice each year.

c) It shall be the duty of the Advisory Council to consult with and advise the Secretary with respect to the administration of this Act.

Appendix B

*Statements on Federal Reinsurance of Private Pension Plans Presented in Connection with Hearings on S. 1575**

STATEMENT OF THE BUREAU OF THE BUDGET

The report of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs issued January 15, 1965, made it clear that the public interest in private pension plans is great because of their role in providing economic security to millions of Americans and because of their impact on labor mobility and manpower policy.

The President's Committee, which included representatives from the Bureau of the Budget, identified as in need of attention and improvement the areas of safeguarding and funding of benefits, vesting benefits, and transferring benefits. Among these areas the Committee discussed several possible types of insurance and specifically noted (pp. 57–58) the problems which arise when terminated pension plans leave workers unprotected.

S. 1575 would establish a system of insurance for pension plans as a condition for continued favorable tax treatment. The beneficiaries of a pension plan would be insured against loss of benefits caused by cessation of some of the operations of the employers, and losses incurred upon the sale of pension fund investments.

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* Presented before the Senate Finance Committee, 89th Cong., 2d sess., August 15, 1966. S. 1575 was the version of the Hartke Bill introduced in the Senate on March 18, 1965. It differed from S. 3071 only in minor detail.

The annual premium rates for the above contingencies would be limited to maximums of 1% and ¼ of 1% respectively. If the premiums were inadequate to cover losses, then the benefits would be limited to various priority groups and the Secretary of Health, Education, and Welfare could also borrow from the Treasury to meet these liabilities.

The development of an insurance approach to pool risks among all pension plans would appear to merit exploration as part of the broader effort to strengthen the protection afforded by pensions. However, S. 1575 raises a number of problems or questions for which there do not appear to be available at present adequate answers or solutions. Among these are the following:

1. What risks are appropriate to cover through insurance and which ones are intended to be insured under the present bill? The bill conceivably would require the Government to pay losses incurred because of poor management, changes in corporate structure, etc.

2. Should not premiums be structured by different degrees of risk? The bill prevents adjusting the premium rate, except below 1%. Thus, the premium provisions do not provide an incentive for plan managers to correct situations which would result in defaults.

3. Would limiting the premium to only 1% lead companies with better funded plans to reduce their contributions to them and thus reduce the level of their funding? This could happen because the reinsurance at a low premium rate would remove the pressure to build up reserves against future liabilities in pension funds. Protected by reinsurance at a low rate, these funds might be invested in other ways.

4. What alternative solutions, such as standards for funding, for discharge of fiduciary obligations or for investment of funds might accomplish some of the same objectives?

5. It is not unusual to design a reinsurance system and fund which apparently contemplates the failure to cover the system's liabilities? Might not the inclusion of borrowing authority from the Treasury lead to demands for outright subsidy of the pension plans?

Many of the problems in the private pension field, especially the question of insurance, are difficult of solution, because of the dearth of statistical information on pension programs. Nor are the data available to provide a basis for setting premiums accurately. There are thus not available at this time the basic data necessary to properly evaluate reinsurance proposals. The executive branch is now working to fill some of these gaps.

The Bureau of the Budget believes that exploration of insurance protection for private pensions is desirable. However, for the reasons indicated above, we recommend that action on S. 1575 be deferred until the necessary information can be developed and evaluation of related alternatives completed.

WILFRED H. ROMMEL
Assistant Director for Legislative Reference

STATEMENT OF DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Under this bill, in order to receive continued favorable tax treatment a qualified pension plan would be required to pay reinsurance premiums. The beneficiaries of such a pension plan would, after three years, be insured up to a specified limit against loss of pension benefits to which they are entitled, if such losses are attributable to insufficient plan resources resulting from either of the following two contingencies:

A. Cessation of one or more of the operations in one or more facilities of the employer.

B. Losses incurred upon the sale of pension fund investments if the sale is required to provide benefits payable.

Annual premium rates could not exceed one percent of an "insured pension fund's" unfunded obligations for contingency (A), and could not exceed one-fourth of one percent of a pension fund's assets for contingency (B). If the premiums are inadequate to pay all losses, then the insurance would be limited to beneficiaries in the upper priority groups established by the bill.

The reinsurance program would be administered by, or under the direction and control of, the Secretary of Health, Education, and Welfare. The Secretary, along with an Advisory

Council (appointed by the President), would be specifically responsible for (1) establishing formulas for determining unfunded obligations and assets of private pension funds; (2) establishing separate premium rates for each contingency insured against; and (3) establishing a revolving fund into which all premium income will be paid and from which benefit disbursements will be made.

Notification of persons eligible for reinsurance benefits would presumably be accomplished through coordination of the program with social security records, although the bill is not explicit on this point.

While it is generally agreed that the intent of the proposed bill has considerable merit, a number of technical uncertainties concerning specific provisions of the bill remain unresolved. Moreover, in its present form the bill contains a number of shortcomings, especially with regard to controls, the calculation and assessment of premium rates, and the indefinite nature of the protection provided. Any workable insurance system must contain provisions that precisely define the risk or risks covered, the financing arrangements and their relationship to the protection provided, and the controls necessary to provide safeguards against imprudent operation and manipulation.

We would suggest that the following questions raised by the bill be given further study:

1. *To what extent are the types of risks covered in the bill insurable?* With respect to contingency (A), since the operations of a business can cease for a variety of reasons, it may be desirable to differentiate among the causes of termination. For example, the risks covered by the bill, as now written, include events that may be subject to control by the employer, such as sales or mergers. The risk covered by contingency (B) involves a high degree of individual selection—that involved in choice of investments and timing of liquidation. Even if such a risk is considered insurable, it is possible to provide such insurance without imposing investment and funding standards additional to those very limited standards now imposed? Further, what would be the effects of more stringent standards on the future development of private pension plans?

2. *Is it feasible to calculate premiums under the formulas used in the bill?* With respect to contingency (A), the bill uses as a basis for calculating premiums the unfunded liability. Generally, the size of an unfunded liability can vary according to the actuarial funding formulas and the actuarial assumptions employed in calculating it. It is questionable whether the unfunded liability, by itself, is a reasonable and feasible basis for calculating premiums since there are many variables that influence the risk of business failure. With respect to contingency (B), the bill provides for calculation of premium rates in relation to a pension fund's assets. The latter, however, vary according to the quality of the portfolio and the amount of equities owned. It would be very difficult to calculate a premium that would accurately reflect the soundness of different types of investment.

3. *What alternative solutions are there to the problem of pension fund losses, particuarly losses due to the risk of business failure?* For example, what are the possibilities of some kind of pooling of the risk, perhaps on an assessment basis, either in conjunction with reinsurance or other methods?

Questions of this nature will be discussed in a series of meetings that the Executive Branch through an interagency task force on private pension plans is holding this summer and fall with nongovernment technicians. At these meetings, a number of closely-related public policy issues, such as those dealing with vesting and funding standards, will be discussed. These issues should be considered concurrently with the question of reinsurance.

We think that it would also be useful to have additional information, now being collected, on such matters as the experience of terminated plans and the extent to which plans are funded, before action is taken on S. 1575.

We, therefore, recommend deferral of action on S. 1575 until there has been an opportunity to analyze the results of these discussions and studies.

We are advised by the Bureau of the Budget that there is no objection to the presentation of this report from the standpoint of the Administration's program.

WILBUR J. COHEN
Under Secretary

STATEMENT OF DEPARTMENT OF LABOR

Millions of workers and their dependents now rely on private pension plans to help meet the financial needs of their later years. Unfortunately, each year a number of these plans are unable to meet their obligations. S. 1575 reflects a constructive attempt to provide limited protections for the beneficiaries of certain pension funds through a system of reinsurance. There may be other approaches. This bill provides your Committee with a useful opportunity to consider the problem areas and the means for arriving at a solution.

The Department of Labor strongly supports the efforts being made by your Committee to deal with the many difficulties in this area. As you know, the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs has also been considering reinsurance and other proposals looking towards the improvement of private pension plans. In its 1965 report, the Committee suggested that further study be given to various aspects of reinsurance proposals.

Among those matters which should be considered are: (1) reasons for termination of plans (2) types of risks to be covered under a reinsurance program (3) equitable methods of calculating premiums to insure such risks (4) possible funding and investment standards which should be applicable to covered plans in order to assure a minimum of risk to the integrity of reinsurance programs (5) other means besides reinsurance to protect pension plan beneficiaries.

Studies are already under way in some of these areas. The Department of Labor's Bureau of Labor Statistics and the Internal Revenue Service are now conducting a study of the reasons for the termination of pension plans and the number of plan participants involved in such terminations. In addition, an interagency task force is in the process of meeting with representatives of various groups outside the Government to examine a broad range of problems related to the sound administration of private pension plans, including the matter of reinsurance. Other studies will be necessary.

This Department believes that the development of adequate legislation assuring protections to the beneficiaries of private pension plans is essential. We will provide the fullest degree of cooperation and assistance to your Committee in working out some of the difficulties in this area.

The Bureau of the Budget advises that there is no objection from the standpoint of the Administration's program to the submission of this report.

W. WILLARD WIRTZ
Secretary of Labor

STATEMENT OF TREASURY DEPARTMENT

Generally speaking, the bill would establish an insurance program to protect beneficiaries of private pension plans against certain types of risks. Administered by the Department of Health, Education, and Welfare, the program is to be financed by contributions by the member pension plans. The premium rates are (subject to specified maximum limits) to be set by the Secretary of the Department of Health, Education, and Welfare with the advice of an advisory council to be established under provisions of the bill. The program is to insure the beneficiaries of pension plans against loss of plan benefits arising from: (1) failure of the amounts contributed to the plan to provide anticipated benefits due to the cessation of one or more of the operations in one or more facilities of the employer; or (2) losses realized upon the sale of investments if the sale is required to provide benefits payable by the plan.

The bill provides that benefits will be insured only to the extent of the lesser of $500 per month or 50 percent of the beneficiary's average monthly wage in the five-year period for which his earnings were the greatest. In the event that the fund's resources are not sufficient to meet all claims against it, the resources available are to be applied to the discharge of obligations in accordance with a schedule of priorities set out in the bill, based chiefly on the age of the beneficiaries.

To encourage participation in the insurance program, the bill would deny tax qualification under section 401 of the Internal Revenue Code to any pension plan which is not insured under the program.

The Treasury Department supports the objective of S. 1575. It agrees with the conclusion in the Report of the President's Committee on Corporate Pension Funds that:

> The value of private pension plans as a socially desirable supplement to the public retirement system depends on the degree to which accumulated funds are sufficient to pay the pension benefits of workers as they reach retirement. This is a matter of utmost public importance.

A program which would assure employees of receiving their accrued benefits on the termination of a pension plan would, in the opinion of this Department, be a meaningful step in strengthening the private retirement system in this regard. To this end, the President's Committee recommended, and this Department agrees, that serious study be given to consider whether a system of insurance would accomplish this objective. If so, the Treasury Department believes that conditioning a plan's tax qualification on its participation in such an insurance program is an appropriate method for encouraging plans to adopt the program.

On the other hand, as the Report of the President's Committee recognizes, the development of such an insurance program raises a number of difficult questions. Since many of these questions are not within the particular competence of the Treasury Department, we are not in a position to make a judgment as to whether the program contained in S. 1575 is an appropriate solution.

The Treasury Department does believe, however, that there are certain guidelines which should be followed in developing any insurance program of the type envisioned by the bill. First, we believe that such an insurance program cannot be considered independently of the question of what funding standards should be applied to private retirement plans. In this regard, the Report of the President's Committee contains a series of recommendations for improving the funding of private retirement plans as well as for verifying that the funding standards are, in fact, met. An insurance program without adequate funding requirements could well operate to encourage employers to rely on the insurance rather than on prudent funding, especially if the insurance premiums were significantly less than the costs of adequate funding. If reliance on the insurance were to become a widespread practice, the whole program could well become self-defeating.

Moreover, it is essential that the type of risks to be covered by the insurance be carefully defined in order to prevent the possibility of corporate maneuvering to shift plan liabilities to the insurance program. In addition, we note that the Departments of Labor and Health, Education and Welfare have raised a number of other issues including questions regarding investment standards; the determination of insurable risks; and the adequacy and method of calculation of the insurance premiums, including the problem of rating various types of risk.

The Treasury Department would be happy to cooperate in the study of an insurance system as well as in the development of sound funding standards for private retirement plans. In this regard, the Internal Revenue Service is presently participating with the Department of Labor in compiling information on the reasons for plan terminations and the number of plan participants who lose benefits by virtue of terminations. Moreover, the Treasury Department is represented on an interagency task force which has scheduled meetings with a number of interested private groups to discuss some of the proposals included in the Report of the President's Committee. One of the topics on the agenda for these meetings is the matter of insuring employees against loss of benefits on termination of the plan.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the Administration's program to the presentation of this report.

STANLEY S. SURREY
Assistant Secretary

STATEMENT OF HON. W. WILLARD WIRTZ*

Thank you, Mr. Chairman, members of the committee. There are with me this morning Miss Edith Cook, our Associate Solicitor; Peter Henle, Director of Special Projects of the Bureau of Labor Statistics; Mr. Donald Landay, Chief of Employee Benefits Branch, Bureau of Labor Statistics; and Mr. Jack Ballard, Assistant Director of Reports and Analysis, Office of Labor-Management and Welfare-Pension Reports.

I have, Mr. Chairman, a statement which has been filed with the committee. It is my usual practice only to try to summarize it for you. I am frank to say my head is tireder than my mouth right now and I suspect I will be better off if I just read through this if that is all right with the committee.

THE CHAIRMAN: All right.

SECRETARY WIRTZ: We are at the start, as the President has said, of "a great new era for older Americans," when we are beginning to recognize "the right to an adequate income," "the right to a decent home," and "the right to a meaningful retirement." The private pension system is a vital element in the achievement of these rights.

This is a matter of personal financial security for millions of individuals. Annual benefit payments from these plans now total some $3 billion—to almost 3 million beneficiaries. By 1980, coverage of these plans is expected to increase from the approximately 25 million employees now covered to about 42 million. Over the same period, the present $85 billion held in these funds will probably grow to $225 billion. Mr. Chairman, members of the committee, we have gotten used to figures so large that their impact is sometimes lost on us. I can only point out that these are figures of magnitude which in my judgment warrant the country's most serious attention to this problem.

* Hon. Wirtz, Secretary of Labor, was accompanied by Miss Edith Cook, associate solicitor; Peter Henle, director of special projects, Bureau of Labor Statistics; Donald Landay, chief, Employee Benefits Branch, Bureau of Labor Statistics; and Jack Ballard, assistant director for reports and analysis, Office of Labor-Management and Welfare-Pension Reports.

These facts make it plain that the Nation, as a whole, has a major stake in the private retirement system. Although no public funds are utilized directly to finance private pensions, practically all private plans have met the qualifications for special income tax treatment. As a result, a given pension system can be financed by a 30-percent-lower rate of contributions. The burden of these tax reductions is, of course, shifted to other taxpayers. Private retirement plans, moreover, represent a force of substantial magnitude in the financing of the economy, the mobility of labor, and the later lives of the plan participants.

These important considerations require a continuing public concern with the operations of private pension plans. Congress has already demonstrated this concern in enacting various provisions of the Tax Code, the Labor Management Relations Act, the Securities Exchange Act, and the Welfare and Pension Plans Disclosure Act.

More recently, the public stake in the private pension plan system was emphasized when the President established in March 1962 a Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs. I have had the privilege of serving as Chairman of this Interagency Committee which looked into a broad range of problems relating to private welfare and pension plans. In its January 1965 report, the Committee recommended a number of measures to strengthen the private pension system. I should like to interrupt, Mr. Chairman and members of the committee, to pay my respects to that Committee with which it was my pleasure to work. It is a Committee which has taken its assignments more seriously than any other which it has been my privilege to work with while I have been in the Government. It reached unanimous conclusions on every single point. It favored, for example, strengthening the minimum standard for funding and introducing a standard for vesting. It went on to suggest that a system of insurance to protect beneficiaries in the event of plan termination was "worthy of serious study." That appears at page 58 of that report which I should like to offer as part of the record before this committee, identifying it as "Public Policy and Private Pension Programs," a report to the President on private employee retirement plans by the

President's Committee, for such disposition as the committee may care to make of it.

(The report, "Public Policy and Private Pension Programs," was filed with the committee.)

This hearing is concerned with a specific proposal to enact such a system of insurance. It is aimed at providing protection for beneficiaries in the event the pension plan is terminated without sufficient funds to meet accumulated pension obligations. To the breadwinner who has planned his retirement in the expectation of regular pension payments, the failure to fulfill these payments is obviously a crushing blow to his hopes, his plans, and his aspirations. I would like to commend this committee for these hearings, for inquiring into a matter which is at once highly complex and highly charged with the public interest.

It is clear that many plans do not now afford beneficiaries adequate protection against the loss of their accrued benefits. Employers customarily reserve the right to discontinue contributions at any time and do not assume contractual liability for any deficiency if the assets in the fund are not adequate to pay the benefits under the plan. If the plan is terminated for any reason, the employer has no further obligation to contribute to the fund.

Union agreements may somewhat minimize these risks. Multiemployer agreements, for example, typically provide for a fixed rate of contributions, such as 10 cents an hour or 3 percent of payroll. Single employer plans, on the other hand, may require that a specified funding plan be followed to provide certain benefits—normal cost plus amortization of past service costs over 30 years just as an example. Yet in all these instances, the employer's obligation ceases when and if the plan should terminate.

Let me illustrate the problem by referring to the experience of the pension plans of a few prominent concerns. In general, these plans were operated in the same prudent manner as those of other highly respected corporations. Yet, in each case the plan termination left many employees without the retirement protection on which they had been relying. You have already referred, Mr. Chairman, to what is the classic example, the 1964 closing of the South Bend, Ind., plant of the Studebaker Corp. In this instance, the available assets were adequate to assure all eligible participants of full pension payments. However, these payments so depleted the fund's assets that employees with vested rights—those between ages 40 and 60 and with 10 years of service—received lump sum payments that were equal to only 15 percent of their accrued benefits. No payments were made to the remaining participants.

A similar situation occurred when the Packard Motor Co. shut down its Detroit plant in 1955–56 and terminated its plan in 1958. The Steelworkers union has listed 30 plans that have terminated owing to plant closings in the past half-dozen years. They include such plants as Superior Steel in Pittsburgh and Atkins Saw in Indianapolis.

To help meet the problem of plan failures owing to bankruptcy, the Department of Labor has, for a number of years, actively supported legislation which would treat payments due to funds or plans as wages for the purpose of the Bankruptcy Act. Such treatment would entitle these obligations to a limited priority under that act. While legislation of this type might be helpful, it is obviously an answer to only a very small part of the problem. The law could be brought to bear only if the employer had an outstanding legal obligation to the fund. Little benefit would be derived if the employer's assets were insufficient to meet even its priority debts. And, in almost all terminations, the problem is not that employers are delinquent in their payments to the fund but rather that the fund's assets, including any such delinquencies, are not sufficient to pay the accumulated pension obligations.

The Welfare and Pension Plans Disclosure Act, which the Department of Labor administers, is of limited usefulness, too, in this area. As important as this law is, it affords little or no protection against failures due to discontinuance of operations by an employer, poor business judgment, decline in value of fund assets, or other such causes. The act specifically denies the Secretary of Labor any authority "to regulate, or interfere in the management of, any employee welfare or pension benefit plans," except for the limited purpose of inquiry into investments and actuarial assumptions, under special procedures and on presumption that the act has been violated.

The legislation which you the considering today, S. 1575, is a serious, constructive attempt to deal with these difficulties and to provide beneficiaries of private pension plans with limited protection through a Federal reinsurance program. For this and other reasons already stated, I wholeheartedly endorse the purposes and objectives of this bill.

In considering this proposal, it is important to keep in mind that there are often no perfect solutions to difficult problems. Until others come up with better answers, this bill, honestly put as it is, is as much entitled to the field of our consideration as any other proposal aimed at correcting these obvious ills.

In discussing this issue, it is important for the committee to keep in mind that this proposal is aimed at providing an important aspect of protection to plan participants; namely, protection in the event of the plan's termination. There are, however, additional public policy issues closely related to this problem. Among these are possible discrimination in coverage of the plan, protection against a plan's failure to provide benefits for lack of vesting, inadequate funding, and possible abuse of fiduciary responsibility in the management of pension funds. The present proposal, therefore, must be viewed as one possible step toward providing additional protection for plan participants, but it is by no means the only step which should be considered.

The difficulties in the path of developing a feasible system of insurance for private pension plans are many. The bill before you makes an admirable attempt to meet a number of these problem areas. Yet its provisions do raise some complex issues which require further study and discussion. I would like to refer to a few.

Perhaps the most important problem area involves the question of standards. If the Federal Government were to take upon itself the obligation of insuring private pension funds, compliance with certain minimum operating standards would appear to be required. Without standards to assure adequate funding, prudent investment practices, and competent, honest management of these plans, a reinsurance program could have the effect of subsidizing imprudent procedures and inadequate funding.

It is important to recall that other, somewhat analogous, Federal insurance programs embody necessary controls or standards. The Federal Housing Administration, for example, does not insure mortgages unless both the borrower and the property meet certain minimum standards. Similarly, the Federal Deposit Insurance Corporation and the Savings and Loan Insurance Corporation have standards that loans and investments must meet in order that banks and savings and loan associations may continue the insurance of their deposits.

Another question concerns the appropriate rate structure. The proposed legislation covers losses attributable to cessation of either part or all of an employer's operations and losses which occur when investments must be sold to pay benefits. There is little information available indicating how the risk of loss varies for these perils among types of employers and types of plans. It seems desirable that any rate structure reflect these differences in risk.

Other questions arise with respect to S. 1575. For example, it provides for termination of insurance protection whenever a plan or its operation fails to comply with basic requirements of the insurance system. The consequences of any such termination of insurance protection would, of course, fall most heavily upon the beneficiaries. Other methods of enforcing compliance should be seriously considered.

These are some of the problem areas which would appear to require additional study. In some areas, a start toward such study is being made. The Department of Labor, in cooperation with the Internal Revenue Service, has undertaken a special study of plan terminations aimed at identifying more closely the reasons for termination and their prevalence. I can give you, if you are interested, Mr. Chairman and members of the committee, just some of the prime indications of the study as it has already been undertaken but they will perhaps be very preliminary and inconclusive. An interagency task force is currently exploring problems affecting private pension plans. This group has planned a series of meetings with various groups outside of Government, including representatives of business, labor, and interested professional groups, to discuss a full range of problems, including reïnsurance proposals.

Let me emphasize that these efforts currently underway can only serve as a starting point. By themselves, they cannot provide sufficient information to formulate an effective reinsurance program. Further studies will undoubtedly be necessary. The Department of Labor intends to pursue these efforts with all due dispatch and to the limit of its available resources. We will work in collaboration with other Federal agencies concerned—especially the Treasury Department—and will provide the fullest cooperation to your committee in the development of legislative proposals.

Our efforts will be strengthened by the concern this committee is displaying by holding these hearings. We recognize full well the key role which the private pension system is playing in assuring retirement security to millions of employees. In general, this system has operated effectively, efficiently, and honestly. However, its continued success must not be jeopardized by certain weaknesses which not only may lead to the loss of retirement protection for many individuals, but also may undermine the public's confidence in the promise of the private pension system.

STATEMENT OF WALTER P. REUTHER*

I appreciate the opportunity to appear before this Committee to urge prompt consideration and early enactment of a self-supporting Federal reinsurance program to safeguard at least a basic portion of the retirement benefit promises currently held out to millions of wage earners in America under private pension plans.

The basic concepts of such a program are embodied in Senate Bill 1575, introduced by Senator Hartke in the First Session of this Congress and now in the hands of your Committee. These concepts are soundly conceived and there is urgent need for Federal legislation based on them.

My appearance here is in two capacities: as President of the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America, UAW, with more than 1,650,000 active and retired members; and as President of the Industrial Union Department of the AFL–CIO, whose consti-

* President, International Union, UAW, and president, Industrial Union Department, AFL–CIO.

uent unions represent more than 8 million members. Both the UAW and the IUD, by unanimous action of their constitutional conventions within the past year, have reaffirmed and remphasized positions taken at prior conventions going back to 1961, calling for development and implementation of a Federal pension reinsurance program.

UAW EXPERIENCE

We in the UAW are proud of our Union's role in the growth and shaping of private pension arrangements in America. The fact that these arrangements are looked to as a vital and significant supplement to the basic Social Security system in most segments of American industry reflects in very substantial measure the results of free collective bargaining between unions and management.

The first UAW pension plan was negotiated with the Ford Motor Company in the fall of 1949. It constituted a historic breakthrough in the establishment of formal funded retirement programs for hourly-paid workers in the mass-production industries.

The UAW now has over 1000 pension plans with employers in automotive, aerospace, agricultural implement and related industries. These plans cover over 1¼ million active workers and are currently paying monthly benefits to more than 180,000 retired UAW members. Estimated assets currently accrued in the pension funds of the plans are approximately $2½ billion. Annual contributions to these funds, apart from interest earnings, total an estimated $350 million and annual pension disbursements exceed $220 million.

From the outset, the union has placed emphasis on certain basic principles which we considered essential to the building of sound retirement security programs. These have included:

—insistence on responsible arrangements, as part of the collective bargaining contract, for the progressive funding of agreed pension benefits through regular contributions into an irrevocable fund (held either by a bank or trust company, as trustee, or by an insurance company) based on determinations by a qualified independent actuary:

—benefits based on recognition of past service accrued before establishment of the plan, or before the date of a negotiated benefit improvement, in order to give meaningful protection to the older and long-employed workers with little or no opportunity to build such protection through "future service":

—benefit provisions both for normal and early age retirement and for disability retirement, supplemental and in addition to the worker's Social Security:

—achievement of pension portability through progressively improved vesting features to preserve earned pension rights in case of employment termination prior to retirement.

In the great majority of UAW pension plans, the application of these principles has provided and may be expected to continue to provide a significant measure of retirement security, with assurance that promised benefits will be delivered when due and will be paid for life to eligible workers and their spouses. Our concern here is with the problems created in the minority of situations where, as a result of business failure, plant closing or removal, discontinuance of manufacturing operations or other factors, the pension plan terminates at a time when currently accrued assets are insufficient to provide promised benefits.

113 PENSION PLAN TERMINATIONS

Over the past 15 years the UAW has had direct experience with 113 pension plan terminations involving companies ranging in size from Studebaker, which employed 7,000 workers in South Bend when it discontinued auto manufacturing in that community in December 1963, to an independent parts supplier with less than 20 employes.

A number of the terminations affected only particular subsidiaries or divisions of larger corporations with which, in several cases, our Union still has collective bargaining relations and going pension plans at other locations. This is true, incidentally, of Studebaker Corporation. Most involved complete liquidation of a business.

Mergers, technological change, marketing problems or competitive pressures played a part in most of the management decisions to close out or move operations. In nearly all of the situations, when we sat down with management representatives to examine fund balance sheets and to agree on termination procedures, both sides of the table were brought face to face with the human problem of telling at least some of the workers that, in addition to the loss of their jobs, all or part of the pension expectations on which they had reasonably relied could not be fulfilled.

Such news can be a heavy and tragic blow for the workers affected—its impact increasing in direct proportion to their ages, their length of service at stake and chances for further employment. In some of the more fortunate situations, denial or proration of accrued benefits on plan termination was limited to relatively young workers or those with recent hire dates. More typically, available assets have been sufficient to provide full benefits for retirees and also for non-retired workers at or close to minimum retirement age, but could provide only two-thirds, one half or less of earned pension for those in the next lower priority group specified in the plan. In a few instances, involving a large concentration of older long-service workers eligible to retire in the first years after setting up of the plan, termination early in the process of funding initial past service liabilities necessitated cuts in pensions already granted.

The Studebaker experience, to which Senator Hartke made specific reference in introducing his bill, has attracted national attention. What happened in that situation well illustrates the general problem.

Although car manufacturing at Studebaker's South Bend plants ceased at the end of 1963, the Studebaker–UAW pension plan was not formally terminated until November 1, 1964, following expiration of the collective bargaining agreement. As of that date, Studebaker's contractual funding obligations ceased and employes, former employes and pensioners could look only to the approximately $25 million in assets built up in the fund during the 14-year life of the plan for discharge of their pension equity. At that time the schedule of past service liability amortization, provided contractually on the same actuarial basis as in other auto industry plans, would have brought the plan to "fully funded" status by 1989.

In round numbers, a total of approximately 10,500 persons were determined to have a potential equity in the fund on termination date by reason of retirement, current seniority status or former employment with vested rights. These persons could be roughly divided in three groups:

1. About 3600 were on pension or were eligible for pensions on the basis of having reached age 60 with 10 or more years' service by the termination date.
2. Another 4000 employees and former employees fell in the age 40–59 bracket with at least 10 years' service, qualifying them for full vesting of their equity under the terms of the Plan.
3. About 2900 were still on plant seniority rolls but were either under age 40 or lacked service for vesting.

The assets were adequate to guarantee full lifetime pensions for the first group (age 60 and over) only. After purchase of paid-up annuities from an insurance company selected on a competitive bid basis, approximately $2.4 million remained for the second group. This represented *only 15%* of the reserve estimated as necessary to provide their accrued pensions. Because of its insufficiency for any meaningful retirement benefits, the money was distributed by agreement in the form of lump sum payments averaging $600. Individual amounts ranged from $200 to $1,600.

No benefits were available for the 2900 employees in the third group.

Statistics on the second group of 4000 "vested" Studebaker workers show an average age of 52 with an average service with the Company of just under 23 years. Averages, however, give only part of the picture. One of the members of the local Union Committee participating in the plan termination discussions was 59 years old with 43 years of Studebaker service since entering the plant at age 16. He was one of more than 20 workers with service in excess of 40 years who missed by a few months the minimum retirement age of 60 and could not receive a pension.

THE NATIONAL SITUATION

The situations confronting workers involved in the Studebaker and other terminations of UAW–negotiated pension plans are in no way unique.

Available governmental statistics indicate that some 7,000 retirement plans in the United States, previously approved for tax exemption by the Internal Revenue Service, were terminated between 1953 and 1965. Approximately 500 were terminated in each of the years 1964 and 1965. Although data are not currently available on the numbers of employees affected or on the funding condition of these plans at the point of termination, there can be little doubt that their discontinuance cancelled or drastically reduced the pension expectations of many thousands of workers.

Secretary Wirtz in his testimony on May 9, 1966, before the Fiscal Policy Committee of the Joint Economic Committee mentioned the need for definitive research in this area and indicated that the Bureau of Labor Statistics and the Internal Revenue Service are currently collecting and analyzing data on the reasons for terminations of tax-qualified retirement plans over the past 12 years and the effect on plan participants. I heartily concur in the need for research of this type and for continuing study by these agencies and other groups, in government and without, in order to shed as much light as possible on the size and scope of the problem. Data collected will be of great value in implementation of a sound and effective program. But the filling of every last data gap should not be allowed to become a basis for delaying responsible consideration and early action on the legislation here under discussion.

In the case of Federal insurance of bank deposits and Federal insurance of mortgages, the consideration and enactment of legislation by Congress was based on examination of basic concepts and issues. I believe the same approach can and must be followed in extending the tested principles of these vital and universally accepted pieces of social legislation to create an effective mechanism for reinsuring private pension plans.

Today more than 25 million Americans are covered by such plans. Estimates indicate that this will increase to 34 million by 1970 and 42 million by 1980. Some 2½ million retired men and women are currently drawing benefits under these plans, and estimates place the number at 7 million by 1980.

According to most recent SEC statistics, the invested reserves of private pension plans at the beginning of this year exceeded

$85 billion, with $58 billion represented by assets in self-insured trusts and the remaining $27 billion by reserves held by insurance companies. The net increase last year was approximately $8 billion in both types of funds and projections to the 1980 indicate a potential private plan reserve total of $225 billion. By that date it is estimated that the present annual benefit payout of almost $3 billion will have tripled to at least $9 billion.

Figures such as these give some indication of the degree to which the public interest is involved in private pension plans and their impact, present and potential, on the operation of the economy and on the retirement security and expectations of millions of working men and women. The necessity and justification for governmental concern is further underlined by the fact the plans are to a significant degree subsidized by Federal taxpayers through the favored tax treatment accorded them under the Internal Revenue Code as part of a long-standing public policy of encouraging their growth and development as a significant supplement to our basic Social Security system.

The extent and nature of this public interest have been dealt with at length by the President's Committee on Corporate Pension Funds and other Private Retirement and Welfare Programs (the Cabinet Committee) in its January, 1965 report on "*Public Policy and Private Pension Programs.*"

As you are undoubtedly aware, that report included a recommendation concurred in by the President's Labor-Management Advisory Committee, that serious study should be given to a pension reinsurance system. More recently, the National Commission on Technology, Automation and Economic Progress in its report to the President and Congress, under the heading "Protecting the Earned Benefit Rights of Displaced Employees," states:

> We favor whatever legislative or administrative measures may be necessary to promote greater equity and security in the establishment and administration of private pension plans. Specifically, we recommend that careful study be given to a legislative system of reinsurance for private pension plans similar to the reinsurance of bank deposits through the Federal Deposit Insurance Corporation.

CONCEPTS AND ISSUES IN REINSURANCE PROGRAM

Various methods and degrees of funding private retirement plans have been developed as a rational way of spreading and allocating benefit costs which sooner or later must be met if promised pensions are to be paid.

Put in the simplest terms, the risk of non-payment arises, as I have indicated in discussing UAW experience, when the plan is terminated at a point where a significant gap exists between available assets and the value of accrued benefits. Such gaps are bound to exist in newer plans which have undertaken to provide benefits based on past service of employees. Also, updating and improvement of benefits, which have been and will continue to be characteristic of most plans if they are adequately to perform their supplementary role in a dynamic economy, inevitably increases funding requirements and the risks of insufficiency of assets in event of unforeseen termination.

To meet this problem a first basic concept of the Federal reinsurance program is that all IRS tax-qualified plans will be required to participate as a condition of continued favorable tax treatment. This approach is the only one which can assure the broadest possible pooling of risk so that premium rates can be held to a minimum and at the same time remove the hazards of "anti-selection" and the essential unpredictability of the factors which may sooner or later require termination of any particular plan. A further compelling reason for the approach lies in the fact that in our interdependent economy, the failure of an enterprise or the closing of a plant is frequently the result of action by others and the cost of insuring the risk of lost pensions for the workers involved should very properly be assessed in some measure against firms directly or indirectly profiting from the action.

A second basic concept is the reinsurance of the risk of investment losses through any forced liquidation required for payment of benefits. This is a relatively minor part of the total risk and provisions of the proposed bill seem to me sound and closely analogous to the principle of reinsurance of bank deposits under FDIC.

A third and possibly the most fundamental concept is the reinsurance of the gap between assets and liabilities on the basis that the reinsurance program will not be providing additional assets for a private plan, but will in effect be guaranteeing missing benefits to the extent that the total entitlement of the beneficiary does not exceed prescribed limits. I strongly endorse this approach, which is, of course, again similar to the well-established principle in FDIC of a limited liability of $10,000* with respect to a single bank deposit.

A fourth concept, involving the framing of the program as a whole, is the establishment of maximum premium rates for both investment and benefit loss risks, within which there is flexibility for the Secretary, with the advice of the Advisory Council, to develop and adjust required premiums. There is also similar discretionary authority for determining and limiting, if necessary, the priority categories of benefits to be covered by reinsurance protection. In my opinion this provision for flexibility within prescribed cost limits is a sound and prudent basis for initiating the program and as an important consideration, it should facilitate early initiation and implementation of this vitally needed social legislation, leaving leeway, as was the case with FDIC, for adjustments which can best be made on the basis of operating experience.

CONCLUSION

With the tremendous expansion of private pension plans in America and their development as a flexible and significant secondary source of retirement income, the security of the pension promise which they represent to millions of wage earners has clearly become a matter of vital public concern.

Establishment of a national mechanism to insure a portion of the risk of inadequacy of plan assets to meet benefit obligations in event of termination is in no sense a threat to the private pension system. On the contrary, such an undertaking will serve to strengthen the private system and to make it more effective while continuing to permit a wide latitude in the design an operation of plans to meet varying needs and circumstances.

The program will be self-financing and constitutes a direct and practical approach to a critical problem which only national

* Now $20,000.

legislative action can solve. Such action is consistent not only with the public policy considerations which have led to special tax exemptions for qualified plans but with the concepts underlying such long-established measures as governmental insurance of bank deposits and mortgages.

STATEMENT OF JEAN M. LINDBERG*

My name is Jean M. Lindberg, a senior vice president of the Chase Manhattan Bank, National Association, New York, N.Y. I am division executive of the pension trust division of the trust department of the bank, which currently serves as trustee, agent, custodian, and investment advisor for more than 1,000 pension, profit sharing, and other forms of deferred employee benefit plans of all sizes and descriptions.

Accompanying me is William Lackman, vice president of the Morgan Guaranty Trust Co., who serves in a similar executive capacity for that bank, and who is chairman of the Committee on Employees Trusts of the Trust Division of the American Bankers Association.

I am here today as a spokesman for the Trust Division of the American Bankers Association.

Among the approximately 13,802 commercial banks in the United States, approximately 3,500 have active trust departments or are trust companies. As of the close of 1965 it was estimated that private retirement programs—of both the pension and the profit-sharing types, had total assets of $85 billion and covered about 25 million employees. Approximately 20 million of these employees were covered under plans funded through trust funds with estimated total assets of $66 billion—with the great bulk of this later figure—perhaps $60 billion being administered by banks and trust companies, principally as trustee, although also in certain other roles. The trust officers of these banks have contributed heavily of their time and energy over many years to stimulate interest in employers in private deferred employee benefit programs and have had a major role in assisting in the development

* Senior vice president, The Chase Manhattan Bank; accompanied by William F. Lackman, vice president, Morgan Guaranty Trust Company.

of the plans in existence today. Consequently, the banking industry has a great interest in maintaining an orderly climate that will not upset present arrangements that have been painstakingly developed—often with some apprehension on the part of employers, particularly small ones, as to just what they are getting into—but also a climate that will continue to stimulate the further growth of an employee fringe benefit that is of great value to superannuated employees and to the general economy as well.

The ABA's trust position in regard to S. 1575 can be simply stated: We believe it would be most inopportune and unwise to enact legislation of this type at this time and perhaps for many years to come, even though the idea may appear attractive on the surface from a theoretical viewpoint. Our reasons are briefly stated as follows:

The bill deals with two types of risks—which from the technical standpoint of insurability are quite different; one is in regard to insuring unfunded liabilities of pension plans—the funding process of which depends on the continuing existence of the contributing employer, whether this be a profitmaking or nonprofit organization. The other is a form of guarantee against market value loss of existing invested assets. Accordingly, our comments will deal with these separately:

1. In regard to the unfunded liabilities—the main problem is that of accrued liabilities for past service credits—that is benefit credits for service rendered in the past—prior to the adoption of a formal funded program. Present IRS Code and regulations require that plans, in order to maintain continued qualification, be funded at least in regard to current service costs plus interest on the unfunded liability for past service credits at the interest rate assumed in the actuarial computations used in determining said liability. Under this minimum procedure, the unfunded liability is theoretically frozen, does not become greater nor is it amortized. It is next to not funding past service credits at all. Most employers when adopting plans, fully intend to amortize these past service credits at a rate that is substantially controlled by their future earnings (or other funds available if a nonprofit organization). Many proceed on the assumption that they will fund over a 10-year, 20-year or longer period and use the resulting

figure as a budget item in forecasting cash flows. As earnings on available funds fluctuate they may increase or decrease this standard amount—but they may not in any event fall below the minimum established by the code and regulations.

In negotiated plans, it is not unusual for the bargaining agreement to specify an amortization period with the annual cost of amortization being translated into the agreed upon wage package as "cents per hour." The much publicized Studebaker case is an excellent example of this—where the company was funding past service credits over 30-year periods, such periods commencing with each newly negotiated retroactive increase in pension benefits. In other words, when the plan was terminated in 1964, the original past service credits established at the inception of the plan in 1950 were approximately 47 percent funded whereas the successive increase in benefits were funded at a lesser percentage. The plan, as negotiated, set up an order of priorities as to the manner in which the then assets would be apportioned in the event of termination—first to retired pensioners and then so on.

Although negotiated plans are substantial in number and asset size, an even greater number of plans the what may be called single employer whereby past service credits are granted voluntarily—to employees who rendered the service in the past with no thought or at least no legal reason to expect such credits. Of course there are many reasons why an employer establishes a pension plan—but the high point for purposes of this discussion, is that the establishment is voluntary and solely within the control of the employer. Past service credits can range from modest to generous.

From all this, a number of points can be made:

(*a*) Assessing a premium against existing plans is imposing a penalty against the very employers who are trying to provide financial security to pension expectations over and beyond the continued existence of the employer.

(*b*) Such a penalty is a retroactive one and had it been in force in the past, it may have discouraged the establishment of some plans now in existence or the past service credits previously granted might have been reduced in order to give effect to the cost of the reinsurance premium.

(*c*) Since the amortization rate for 30-year funding of past service costs is about 6 percent of the original unfunded amount per year, that is for interest and amortization of principal, the suggested premium would increase the first year cost of an employer by about 16 to 17 percent on a 30-year funding basis; the increase would be 10 percent for the 10-percent funding which is the fastest method under the code, and 25 to 30 percent for the "interest only" method.

(*d*) These premium costs could seriously hamper the future growth of private pension plans, particularly for small employers.

2. In order to function properly, the assessment of a premium would have to be on unfunded liabilities which were computed on a uniform basis. At the present time there are considerable differences in actuarial methods and assumptions that are used in computing pension plan liabilities—all of which are technically appropriate in their application. Accordingly, the actuarially determined unfunded liability for a given set of plan benefits can vary depending on the factors assumed and methods used. Any standardization which might be decreed under the administrative provisions of the bill could develop a norm or standard for assessing the propriety of tax deduction by the Internal Revenue Service, requiring conformity or justification—a purpose which is other than the bill's intention and which could force conformity to a less conservative basis than an employer might wish to use to enhance the financial soundness of his plan.

3. The alternatives open to an employer who did not wish to be burdened by the premium would be—

a) To forgo the establishment of a pension plan; or to grant credits and fund for future service only, leaving past service benefits to be granted on an informal out-of-pocket basis or not at all.

b) Establish a profit-sharing plan—which is prospective only, and fully dependent on future profits.

4. Employers whose financial solvency or business future was shaky could be encouraged either on their own volition or through collective bargaining to adopt generous plans or in-

crease benefits, hoping to stay in business just long enough to meet the minimum period under the bill.

5. The insurance factor makes no distinction between financially strong and mature employers and weak or insolvent ones. Previous testimony seemed to refer exclusively to corporation or corporate and profitmaking organizations, but questions can also be raised regarding coverage of employees of various unincorporated employers, associations, charitable organizations which can be easily formed and just as easily collapsed.

6. In regard to the second type of risk—that to protect against losses realized upon sale of investments if such sale is for the purpose of providing benefits—one broad point can be made. It is difficult to envision such a system of insurance that would not involve regulation of investment as to type and quality since the measure of risk is directly related to the type of investment. Experience shows that such regulation is difficult since at any given time there are reasonable differences of opinion among investment professionals regarding specific securities and other forms of investment—regarding quality, prospects, timing, and so forth. Beyond this, losses could be, and have been suffered on bond issues of the highest quality—even on U.S. Government obligations due to market value changes based on changes in current interest rates.

On the other hand, the absence of such regulation, but the presence of an insurance feature could create tendencies on the part of some fund managers to be overly aggressive, "to reach out," in the parlance of the trade, because losses will be subsidized by others.

7. In conclusion, we can sum up our views in this manner:

a) Although the concept is a worthy one, the areas of technical difficulty which will be created by the bill are many and varied. It is doubtful that satisfactory methods can be found to obviate these difficulties without restructuring the entire private pension plan field.

b) Since a large number of existing plans were established on a voluntary basis, it would be unfair to apply the premiums suggested by the bill to existing benefits.

c) The premiums suggested are substantial and would prove costly—thereby inhibiting adoption of past service liabilities.

d) The bill is aimed at plans that are or will be in the process of funding to build financial security for employees but does not touch the employer who has no plan, or who is operating his plan on an unfunded basis—and therefore a less secure one.

e) And, finally, the broad comment might be made, that if it is accepted that private pension plans are highly desirable and should be encouraged—and all quarters seem to be in accord on this—it is quite possible that the enactment of this bill will discourage rather than encourage the creation of new plans, or better benefits in existing ones—particularly among smaller employers—where the greatest number of uncovered employees are to be found.

As an aside, last year there were something like 10,000 new pension and profit-sharing plans created, and I think that the average coverage under such plans was in the neighborhood of 100 employees, so this is where the great bulk of new plans are going to arise.

My associates join me in thanking the Finance Committee for permitting us to appear here today and hope that our views will prove informative and helpful. I will be pleased to attempt to answer any questions you may have or to clarify any portion of our statement.

Appendix C

Federal Reinsurance of Private Pension Plans

*by Howard Young**

For some years now, there have been proposals that the Federal Government establish a reinsurance program for private pension plans to assure payment of benefits even if the assets of the plan are inadequate to provide such benefits due to termination of the plan. In 1964, a bill was introduced in the Senate by Mr. Hartke and others: Senator Hartke reintroduced the bill, with minor modifications, on March 18, 1965, as S. 1575.[1]

The establishment of pension plans, and the periodic improvement of such plans, results in most plans having assets at any particular time which are less than the value of benefits accrued to that time.[2] While some people have suggested that this problem be avoided by confining changes in the plan to affect only benefits which will accrue in the future and to fully fund all benefits as accrued, this is somewhat like suggesting that the best way to protect a valuable jewel from possible loss is never to wear it. A large part of the value of the jewel lies in the ability to display it, even if this entails some risk of loss.

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* Actuarial consultant, UAW (a paper presented before the Chicago Actuarial Club, April 19, 1965).

1 A corresponding bill was introduced in the House (H.R. 6944) by Mr. Brademas.

2 The concept of an employee's accrued benefit is not always explicitly defined in a pension plan, but generally it represents the benefit payable to someone currently retiring (as a normal retiree) with the same prior employment record as the employee.

Similarly, the major value of a group pension plan—as opposed to a collection of individual annuity programs for a group of people—lies in the ability to modify the plan to meet changing conditions, and to act as a mechanism for transmitting income from current to prior generations of workers, thus eliminating the features which involve risk would also prevent the most significant utilization of private pension plans.

In explaining the partially funded status of a pension plan, I frequently compare it to the situation of owning a home with a mortgage. If the house is sold before the mortgage is fully amortized, not all of the purchase payment is payable to the owner of the house; he only receives his funded portion of the equity. Similarly in pension plans, at any time only the funded equity is available to the owners (participants and beneficiaries) of the fund. The analogy can be carried one step further: if the mortgage mechanism were never used in purchasing a home, the problems of foreclosure would be avoided, but few of us could enjoy the advantages of homeownership. Similarly, if the unfunded liability mechanism were not utilized, few employee groups would have adequate pension benefits.

Unfortunately, the magnitude of the termination problem is not known. Little data is available on the true relationship between assets of pension plans and the reserves needed for accrued benefits. Even for the plans which terminate, such data is not generally available. Furthermore, as Frank Griffen showed in his recent study[3] the usual basis of reporting such data does not give a realistic picture.

While it is my belief that for most plans a significant gap exists between the value of plan assets and the amount required to provide accrued benefits, I support the Cabinet Committee's recommendation[4] that there is need for research in this area.

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3 Frank L. Griffen, Jr., "Pension Security and Funding Regulation," *The Proceedings of the Conference of Actuaries in Public Practice*, Vol. XIV, 1964–65.

4 President's Committee on Corporate Pension Funds, etc., *Public Policy and Private Pension Programs*, January, 1965.

Finally, there seems to be growing feeling—although it is of necessity based on immature data—that technological change will increase the rate of business sales, mergers, and terminations with a consequent increase in the rate of plan terminations. Thus we have a problem which is likely to grow in importance.

All of us are familiar with the Studebaker closing in South Bend. The insistence of the UAW on "funded" pension plans at least resulted in the ability to assure lifetime benefits to all persons over age 60. There was even a little money left over, which will be distributed to those age 50 to 60. However, the commitment to fund past service liabilities over 30-year periods was obviously not adequate to assure full benefits.

In this case "funding" may not even have been the best answer. The fact that Studebaker will continue to exist as a corporation and probably make money, raises the possibility that a corporate guarantee of benefits would have been of greater value. One cannot be sure, however; the remainder of the corporation might go out of business next year. Certainly, for the more typical case, the existence of an independent fund is the best assurance employees can currently get that benefits will be paid.

I only raise questions about the assumption that "funding" is the best answer, because it must be viewed in light of the alternatives. At the present time, for the usual case, "funding" is best. However, if a reinsurance mechanism were available the need for "funding" would be much less. In addition, the usual quid-pro-quo for "funding"—the fact that the corporation has no liability other than its annual contributions—is difficult to rationalize when compared to the other areas in which the corporation's decision to cease operations will presumably cause some future cost: for example, loss on sale of plant and equipment.

The Studebaker situation is cited not only because it is well known, but also because it was the stimulus to Senator Hartke's action. He cited this when introducing the bill in 1964, and when submitting S. 1575 this year.

I have prepared an outline of S. 1575. If you will look that over, it will give you a general idea—without getting into every detail—of the proposal.

An even faster—and less detailed—description of the bill would be the following:

1. All employee plans would have to pay a reinsurance premium to continue to get special tax treatment.
2. After the plan has been reinsured at least 3 years, certain benefits would be guaranteed even if the assets were inadequate due to losses or termination of the plan because the employment unit is shut down.
3. There is a maximum amount which would be guaranteed for any individual, and there are provisions for covering only older employees if that seems necessary to keep the costs of the program at a reasonable level.

Let us now take a longer look at some of the more important provisions.

First, the requirement for compulsory participation. Aside from the usual objections to new Federal programs, the major cry here has been against the requirement that all plans be reinsured.

The fact is, of course, that very few employee groups can be certain they will never need help from the reinsurance fund. It is quite likely that A.T. & T. and GM and a handful of others will never cease operations; but where do we go from there?

Who would have thought in 1950 that Packard—"the symbol of excellence"—would be out of business by 1955? Insurance texts on investment policy point out that in 1900 street railways (trolley cars) were considered among the most secure investments; today few are in existence. It is easy to imagine that a "dream company" such as IBM might be hard put to maintain its employee benefit programs, and even its existence, if some technological discovery by a competitor were to open new areas of data processing.

In other words, as in all forms of insurance, coverage is needed simply because we cannot be sure whether or when a loss will occur.

There is another argument for requiring all plans to pay the reinsurance premium. In our interdependent economy, the closing of a plant is frequently the result of actions by others. The decision of a major purchaser to shift its business will often result in the shutdown of a supplier. The decision of a large company to operate on a smaller profit margin or to expand into new areas will often result in the shutdown of competitors. Thus all employment groups must bear some cost of the shutdown of any group.

Second, the coverage of asset losses. This is a relatively minor problem since the only loss covered is one that occurs when assets must be liquidated to pay current benefits. Very few plans ever have to sell assets to pay benefits; this can generally be accomplished by using current income.

The provision is very interesting, however, because it reminds one of the Federal Deposit Insurance Corporation (FDIC): a reinsurance arrangement for banks. I did some research on the arguments which were advanced in the 1930's against FDIC; they sound very much like those currently being advanced against reinsurance of pension funds. To quote only two sources:

> At the inception of the FDIC, it was criticized as violating recognized principles of insurance, since the rate of assessments is not scaled to the apparent risk of loss among those insured and assessments are paid on deposits in excess of $10,000 even though they are not accorded protection. It was argued that the protection afforded depositors would make it unnecessary for banks to maintain high standards in order to attract business thereby encouraging lax banking methods.[5] Opponents of the plan have advanced several arguments against deposit insurance. One is that it will encourage bad banking and inefficient administration of local institutions by removing the necessity for each bank to preserve itself through good management. Another, that the present plan of assessment places an unfair burden upon large metropolitan banks. That is, their likelihood of failure is less than that of smaller, less diversified rural banks, and so their contribution to the fund should be relatively less.[6] The current appraisal—as one of these same sources

[5] Whittlesey, Freedman, and Herman, *Money and Banking* (New York: The Macmillan Co., 1963), p. 528.

[6] Robinson *et al.*, *Financial Institutions* (Homewood, Ill.: Richard D. Irwin, Inc., 1960), p. 149.

points out—is that "FDIC has become a prized and permanent feature of the country's financial structure."[7]

Third, the coverage of unfunded liabilities. A primary concept is that the bill would guarantee benefits, not the unfunded amount shown in the plan actuary's valuation. Since the premium is intended to be proportional to the amount reinsured, standards would be established as a basis for determining the amount. The plan actuary would not be required to use these standards in determining current contributions; they would only be required for the purpose of determining the reinsurance premium.

To establish these standards an Advisory Council is to be appointed by the President. It would also consider the difficult questions of premium rates—on which the bill establishes a maximum—and of the possible limitation of coverage to classes of older workers if needed to keep the premium within the limits established.

The bill also addresses itself to the question of partial terminations, where there is a shutdown of only one of several employment units covered by a single plan. It is proposed that an appropriate portion of the assets be "spun-off" for the benefit of this unit, with the reinsurance fund assuming any excess liabilities. The remainder of the units could continue to operate their plan independently of the group which had been terminated.

No requirement is established with respect to funding of past service liabilities; although the minimum IRS requirements would, of course, have to be met to maintain qualification. This has created controversy, even among those who are strongly in favor of the bill.

The main argument in favor of requiring funding is based on the assumption that the risk of termination increases with the passage of time. If this is true then the rate of claims would increase each year and soon require very high reinsurance premiums. As in the case of permanent life insurance, funding would alleviate this by reducing the amount at risk as each plan grows older.

My own feeling is that we need more facts. I have been persuaded by some of my economist friends that the true situation

[7] Whittlesey *et al., op. cit.*, p. 528.

may be that after the first few years the probability that a business firm terminates actually decreases.

There are those who feel that funding is not an unmixed blessing. It limits the flexibility of designing programs. It also ties up a substantial amount of assets. The $225 billion level of anticipated pension fund assets by 1980 raises questions concerning the availability of good investments for other forms of saving.

In any event, it must be recognized that the goal is security of benefit expectations and a realistic recognition of costs. Funding is merely a means to that end; if other mechanisms—particularly the reinsurance proposed—can achieve the goal, then our present ideas about the need for funding must be reassessed.

There can be little doubt that the need exists for a new pension mechanism to meet the termination problem. It also seems clear that the Federal Government should establish the program because the cost is one which should be spread to all employment units whether or not they are willing to recognize their own need and obligation to participate.

Whether S. 1575 is the answer should be a subject of intensive debate. In introducing the bill Senator Hartke himself said, "I do not claim that the bill I present is the one and only ultimate answer to the need. But it is at least an effort to devise a means to prevent the kind of situation which too often occurs with the departure of a defunct business."

Actuaries and others should work toward the development of a sound solution, rather than expending energy on denying the problem. If the private pension system is to survive, a means must be developed to assure those currently providing money to pay benefits that their benefits will in fact be paid when they reach retirement age.

Appendix D

S. 1635. Federal Reinsurance of Private Pension Plans Act

*Introduced by Senator Vance Hartke**

A BILL

To establish a self-supporting Federal program to protect employees in the enjoyment of certain rights under private pension plans.

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

SHORT TITLE

SECTION 1. This Act may be cited as the "Federal Protection of Private Pension Plans Act."

DEFINITIONS

SEC. 2. As used in this Act—

a) The term "pension fund" means a trust, annuity plan, or other fund under which an employer undertakes to provide, or assist in providing, retirement benefits for the exclusive benefit of his employees or their beneficiaries. Such term does not include any trust annuity plan or fund established by a self-employed in-

* Introduced April 26, 1967, 90th Cong., 1st sess. This was the third Hartke Bill which modified his earlier proposals by [1] eliminating the protection against losses from forced liquidation of plan assets, [2] making participation in the program mandatory, and [3] granting authority to the Secretary of HEW to discontinue protection of the program for a plan that in the judgment of the Secretary was established with the expectation that termination would occur within five years.

dividual for his own benefit or for the benefit of his survivors or established by one or more owner-employees exclusively for his or their benefit, or for the benefit of his or their survivors.

b) The term "eligible pension fund" means a pension fund which is part of a pension plan which meets the requirements set forth in section 401 of the Internal Revenue Code of 1954 with respect to qualified pension plans.

c) (1) The term "insured pension fund" means an eligible pension fund which has been in operation for not less than three years and, for each of such years, has met the requirements set forth in subsection (*b*) and has been insured under the program established under this Act.

(2) Any addition to, or amendment of a pension plan which includes an insured pension fund shall, if such addition or amendment involves a significant increase (as determined by the Secretary) in the unfounded liability of such pension plan, be regarded as establishing a new and distinct pension fund which can become an "insured pension fund" only upon compliance with the provisions of paragraph (1) of this subsection.

ESTABLISHMENT OF INSURANCE PROGRAM

SEC. 3. There is hereby established in the Department of Health, Education, and Welfare a program to be known as the Federal insurance program for private pension plans (hereinafter referred to as the "program"). The program shall be administered by, or under the direction and control of, the Secretary.

CONTINGENCIES INSURED AGAINST UNDER PROGRAM

SEC. 4. *a*) The program shall insure (to the extent provided in subsection [*b*]) beneficiaries of an insured pension fund against loss of benefits to which they are entitled under such pension fund arising from failure of the amounts contributed to such fund to provide benefits anticipated at the time such fund was established, if such failure is attributable to cessation of one or more of the operations carried on by him in one or more facilities of such employer.

b) The rights of beneficiaries of an insured pension fund shall only be insured under the program to the extent that such rights do not exceed—

(1) in the case of a right to a monthly retirement or disability benefit for the employee himself, the lesser of 50 per centum of his average monthly wage in the five-year period for which his earnings were the greatest, or $500 per month;

(2) in the case of a right on the part of one or more dependents, or members of the family, of the employee, or in the case of a right to a lump-sum survivor benefit on account of the death of an employee, an amount found by the Secretary to be reasonably related to the amount determined under subparagraph (1).

In the case of a periodic benefit which is paid on other than a monthly basis, the monthly equivalent of such benefit shall be regarded as the amount of the monthly benefit for purposes of clauses (1) and (2) of the preceding sentence.

c) If an eligible pension fund has not been insured under the program for at least the three years preceding the time when there occurs the contingency insured against, the rights of beneficiaries shall not be insured and in lieu thereof the premiums made on behalf of such pension fund during such period shall be returned to the pension fund.

PREMIUM FOR PARTICIPATION IN PROGRAM

SEC. 5. *a*) Each eligible pension fund may, upon application therefor, obtain insurance under the program and shall make payment of such annual premiums as may be established by the Secretary. Any pension fund which desires to obtain insurance under the program must agree to continue such insurance in force and pay the premiums thereon until such time as the Secretary determines that such insurance may be terminated without defeating the purposes for which this Act is enacted. The premium rate established under this section shall be uniform for all pension funds insured by the program and shall be applied to the amount of the unfunded obligations of each insured pension fund. The premium rate may be changed from year to year by the Secretary, when the Secretary determines changes to be necessary or desirable to give effect to the purposes of this Act; but in no event shall the premium rate established for the contingency described in section 4 (*a*) exceed 1 per centum for each dollar of unfunded obligations.

b) The Secretary, in determining premium rates, and in establishing formulas for determining unfunded obligations and assets of pension funds, shall consult with, and be guided by the advice of, the Advisory Council (established by section 8).

c) If the Secretary (after consulting with the Advisory Council) determines that, because of the limitation on rate of premium established under subsection (*a*) or for other reasons, it is not feasible to insure against loss of rights of all beneficiaries of insured pension funds, then the Secretary shall insure the rights of beneficiaries in accordance with the following order of priorities—

First: individuals who, at the time when there occurs the contingency insured against, are receiving benefits under the pension fund, and individuals who have attained normal retirement age or if no normal retirement age is fixed have reached the age when an unreduced old-age benefit is payable under title II of the Social Security Act, as amended, and who are eligible, upon retirement, for retirement benefits under the pension fund;

Second: individuals who, at such time, have attained the age for early retirement and who are entitled, upon early retirement, to early retirement benefits under the pension fund; or, if the pension fund plan does not provide for every retirement, individuals who, at such time, have attained age sixty and who, under such pension fund, are eligible for benefits upon retirement;

Third: individuals who, at such time, have attained age forty-five;

Fourth: individuals who, at such time, have attained age forty; and

Fifth: in addition to individuals described in the above priorities, such other individuals as the Secretary, after consulting with the Advisory Council, shall prescribe.

d) Participation in the program by a pension fund shall be terminated by the Secretary without any refund of premium if he determines, within five years after such fund first participates in the program, that the pension fund was established with the expectation that the contingency insured against under the program would occur within five years of the date the pension fund was established.

e) Any pension fund participating in the program shall be legally liable for the payment of the premiums determined by the Secretary for participation in the program until such time as participating by such fund in the program is terminated in accordance with the provisions of this Act. The Secretary shall have the authority and duty to institute appropriate legal proceedings to compel compliance of any participating pension fund to pay such premiums when due.

REVOLVING FUND

SEC. 6. *a*) In carrying out his duties under this Act, the Secretary shall establish a revolving fund into which all amounts paid into the program as premiums shall be deposited and from which all liabilities incurred under the program shall be paid.

b) The Secretary is authorized to borrow from the Treasury such amounts as may be necessary, for deposit into the revolving fund, to meet the liabilities of the program. Moneys borrowed from the Treasury shall bear a rate of interest determined by the Secretary of the Treasury to be equal to the average rate on outstanding marketable obligations of the United States as of the period such moneys are borrowed. Such moneys shall be repaid by the Secretary from premiums paid into the revolving fund.

c) Moneys in the revolving fund not required for current operations shall be invested in obligations of, or guaranteed as to principal and interest by, the United States.

AMENDMENT TO INTERNAL REVENUE CODE

SEC. 7. *a*) Section 401 (a) of the Internal Revenue Code of 1954 (relating to definition of qualified pension and other similar plans) is amended by adding at the end thereof the following new paragraph:

> (11) Notwithstanding the preceding provisions of this subsection, no pension fund which, for any taxable year is insurable under the Federal Protection of Private Pension

Plans Act, shall be a qualified trust under this section if such fund is not insured for such year under the program established under such Act.

b) Section 404 (a) (2) of such Code (relating to deductibility of contributions to employees' annuities) is amended by striking out "section 401 (a) (9) and (10)" and inserting in lieu thereof "section 401 (a) (9), (10), and (11)."

c) The amendments made by this section shall be effective with respect to taxable years which begin not less than six months after the date of enactment of this Act.

ADVISORY COUNCIL

SEC. 8. *a*) There is hereby created a Federal Advisory Council for Insurance of Employees' Pension Funds (hereinafter referred to as the "Advisory Council"), which shall consist of nine members, to be appointed by the President, by and with the advice and consent of the Senate. The President shall select, for appointment to the Council, individuals who are, by reason of training or experience, or both, familiar with and competent to deal with, problems involving employees' pension funds and problems relating to the insurance of such funds. Members of the Council shall be appointed for a term of two years.

b) Members shall be compensated at the rate of $100 per day for each day they are engaged in the duties of the Advisory Council and shall be entitled to reimbursement for traveling expenses incurred in attendance at meetings of the Council. The Advisory Council shall meet at Washington, District of Columbia, upon call of the Secretary who shall serve as Chairman of the Council. Meetings shall be called by such Chairman not less often than twice each year.

c) It shall be the duty of the Advisory Council to consult with and advise the Secretary with respect to the administration of this Act.

Appendix E

S. 1103. Pension and Employee Benefit Act of 1967

*Introduced by Senator Jacob Javits**

. . . .

TITLE II—PENSION REINSURANCE

ESTABLISHMENT OF PROGRAM

SEC. 201. There is hereby established a program to be known as the Federal pension reinsurance program (hereinafter referred to as the "program"). The program shall be administered by, or under the direction and control of, the Commission.

CONTINGENCY INSURED AGAINST UNDER PROGRAM

SEC. 202. *a*) The program shall insure (to the extent provided in subsection [*b*]) beneficiaries of a reinsured pension plan against loss of benefits to which they are entitled under such pension plan arising from substantial cessation of one or more of the operations carried on by the contributing employer in one or more facilities of such employer before funding of the unfunded liabilities of the fund.

b) The rights of beneficiaries of a reinsured pension plan shall be insured under the program only to the extent that such rights do not exceed—

(1) in the case of a right to a monthly retirement or disability benefit for the employee himself, the lesser of 50 per centum of the average monthly wage he received from the con-

* Introduced February 28, 1967, 90th Cong., 1st sess.

tributing employer in the five-year period after the registration date of the plan for which his earnings were the greatest, or $500 per month;

(2) in the case of a right on the part of one or more dependents, or members of the family, of the employee, or in the case of a right to a lump sum survivor benefit on account of the death of an employee, an amount found by the Commission to be reasonably related to the amount determined under subparagraph (1).

In the case of a periodic benefit which is paid on other than a monthly basis, the monthly equivalent of such benefit shall be regarded as the amount of the monthly benefit for purposes of clauses (1) and (2) of the preceding sentence.

c) If a registered pension plan has not been registered under der title I for each of at least the five years preceding the time when there occurs the contingency insured against, the rights of beneficiaries shall not be insured: *Provided,* That the Commission may, in its discretion, credit against the five year requirement of section 202 (*c*) one or more years prior to the effective date of this Act for any pension plan which, during such prior years, would have satisfied the registration requirements of title I had this Act been in effect.

PREMIUM FOR PARTICIPATION IN PROGRAM

SEC. 203. *a*) Each registered pension plan shall pay an annual premium for reinsurance under the program upon payment of such annual premium as may be established by the Commission. Premium rates established under this section shall be uniform for all pension funds insured by the program and shall be applied to the amount of the unfunded liability to each insured pension fund. The premium rates may be changed from year to year by the Commission, when the Commission determines changes to be necessary or desirable to give effect to the purposes of this title; but in no event shall the premium rate exceed 1 per centum for each dollar of unfunded liability. Premiums under this title shall be payable as of January 1, 1968, or, for plans adopted after that date, as of the effective date of such plans.

b) If the Commission determines that, because of the limitation on rate of premium established under subsection (*a*) or for other reasons, it is not feasible to insure against loss of rights of all beneficiaries of reinsured pension plans, then the Commission shall insure the rights of beneficiaries in accordance with the following order of priorities—

First: individuals who, at the time when there occurs the contingency insured against, are receiving benefits under the pension plan, and individuals who have attained normal retirement age or if no normal retirement age is fixed have reached the age when an unreduced old-age benefit is payable under title II of the Social Security Act, as amended, and who are eligible, upon retirement, for retirement benefits under the pension plan;

Second: individuals who, at such time, have attained the age for early retirement and who are entitled, upon early retirement, to early retirement benefits under the pension plan; or, if the pension plan does not provide for early retirement, individuals who, at such time, have attained age sixty and who, under such pension plan, are eligible for benefits upon retirement;

Third: in addition to individuals described in the above priorities, such other individuals as the Commission shall prescribe.

c) Participation in the program by a pension plan shall be terminated by the Commission upon failure, after such reasonable period as the Commission shall prescribe, of such pension fund to make payment of premiums due for participation in the program.

REVOLVING FUND

SEC. 204. *a*) In carrying out its duties under this title, the Commission shall establish a revolving fund into which all amounts paid into the program as premiums shall be deposited and from which all liabilities incurred under the program shall be paid.

b) The Commission is authorized to borrow from the Treasury such amounts as may be necessary, for deposit into the revolving fund, to meet the liabilities of the program. Moneys borrowed from the Treasury shall bear a rate of interest determined by the Secretary of the Treasury to be equal to the average rate on outstanding marketable obligations of the United States as of the period such moneys are borrowed. Such moneys shall be repaid by the Commission from premiums paid into the revolving fund.

c) Moneys in the revolving fund not required for current operations shall be invested in obligations of, or guaranteed as to principal and interest by the United States.

STATEMENT OF SENATOR JAVITS ACCOMPANYING S. 1103

. . . .

C. REINSURANCE

Reinsurance, like portability, sounds fine all by itself, but it is part and parcel of the vesting-funding package. If we are to insure employees that their pensions will be paid even if the employer's business terminates, then we must regulate the pension fund itself, at least to a limited extent. Surely we would not ask the Federal Deposit Insurance Corporation to reinsure bank deposits without some control of the bank's affairs. Yet, if we regulate the fund itself, it seems inevitable that we require some minimum standard of vesting, or else we may be insuring that the money will be there, without insuring that anyone will have a right to receive it when he retires.

This bill reinsures against only one contingency: termination of the employer's business before the unfunded liabilities of the pension plan are funded. The premium is geared to the amount of such unfunded liabilities, and cannot exceed 1 percent of that amount.

This is not the maximum type of pension reinsurance which could be devised. It is not as expansive as a bill introduced last year and subjected to hearings in the Finance Committee. But it meets the major problem: it would, if it had been on the books 5 years ago, have protected against the tragedy in the Studebaker shutdown in South Bend, when one employee who was 59 years old and had worked for Studebaker for 43 years, starting at the age of 16, forfeited 85 percent of his pension rights. And he was not alone, for there were 20 other Studebaker employees each with more than 40 years of service who were in the same boat. Studebaker's plan was a good one. It would have met the vesting and funding standards of this bill, and it could have been reinsured, and those employees could have been 100 percent protected.

I am not prepared to ask for compulsory reinsurance of pension plans without some minimum standards for all. It is easy enough to set up an actuarially unsound plan which is bound to go broke, and then make the solvent plans pay higher premiums to cover the unsound ones. But I do think we can devise a scheme which will let each plan bear a minimal cost of reinsurance, each knowing that every other participant in the reinsurance program is held to the same minimum standards of solvency. That is what this bill would do.

Appendix F

S. 3421. The Pension Benefit Security Act of 1968

*Introduced by Senator Ralph W. Yarborough**

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TITLE III—VESTED LIABILITY INSURANCE

SEC. 301. INSURANCE COVERAGE

a) Every pension plan required to meet a specified funding ratio in accordance with section 201 (*a*) (2) of this Act shall obtain insurance covering unfunded vested liabilities to protect participants and beneficiaries against possible loss of vested benefits arising from an essentially involuntary termination of the plan. The amount of insurance shall be the plan's vested liabilities less the greater of–

(1) 90 percent of the assets needed to meet the funding ratio required under section 201 (*a*) (2), or

(2) 90 percent of the plan's actual assets.

b) The Pension Benefit Insurance Corporation shall issue a certificate of insurance coverage to each plan administrator after receipt by the Corporation from the Secretary of a copy of the statement required by section 202 (*a*). A plan's insurance coverage shall be continuous from the date of issuance of the certificate until cancelled.

* Introduced May 2, 1968, 90th Cong., 2d sess. This bill was sponsored by the Department of Labor and reflected the deliberations of the Interagency Staff Committee which had been charged with the responsibility of implementing the recommendations of the President's Committee on Corporate Pension Funds.

c) The Pension Benefit Insurance Corporation shall not insure—

(1) any unfunded vested liabilities created by a plan amendment which took effect within three years immediately preceding termination of the plan; or

(2) any unfunded vested liabilities resulting from the participation in the plan by a participant owning 10 percent or more of the voting stock of the employer contributing to the plan or by any participant owning a 10 percent or more interest in a partnership contributing to the plan.

SEC. 302. PREMIUMS

a) Each plan shall pay a premium for insurance under this Title at such uniform rates prescribed by the Pension Benefit Insurance Corporation, based upon the amount of unfunded vested liability which is to be insured and upon such other factors as the Corporation determines to be appropriate. The premium for the initial three-year period shall be not more than 0.6 percent of the amount insured.

b) Should any administrator of a plan subject to this Title fail to pay any premiums required to be paid under subsection (*a*), the Pension Benefit Insurance Corporation shall give the administrator of the plan not less than 30 days' notice of intention to cancel insurance unless the premium is paid by the end of such period. If the unpaid premium is not paid by the end of such period, the Corporation shall cancel the plan's certificate of insurance and the plan shall give notice of such cancellation to each person entitled to a vested benefit under the plan.

SEC. 303. CLAIMS PROCEDURE

a) The administrator of a plan insured under the provisions of this Title shall file a claim with the Pension Benefit Insurance Corporation in the event the plan is terminated for reasons of financial difficulty or bankruptcy, plant closing, by order of the Secretary, or such other reasons as the Corporation by regulation shall specify as reflecting an essentially involuntary plan termination. The Corporation shall be authorized to honor such claim up to the limits prescribed by section 304 if it finds that the assets of the plan may not be sufficient to pay vested liabilities.

b) Claims shall be made as specified in the rules and regulations of the Pension Benefit Insurance Corporation. The Corporation shall also require the administrator who files a claim to submit proof of all facts necessary to establish a claim, but in any event, the Corporation may in its discretion independently make such investigation as may be necessary for it to determine the validity of any claim. The Corporation shall require the payment of any contributions owing to the plan and required to meet the funding ratio specified in section 201 (*a*) (2) of this Act, and may sue to recover such contributions on behalf of the plan in connection with settling any claim.

c) The Pension Benefit Insurance Corporation shall give written notice to the administrator of its decision on any claim. Upon notice that a claim will be honored the administrator shall wind up the affairs of the plan by arranging for the purchase of single premium annuities from a qualified life insurance company for each person entitled to vested benefits, or by making such other arrangements for the distribution of vested benefits as the Corporation may by regulation approve as providing adequate protection to persons with vested benefits. The administrator shall be allowed a reasonable period in which to liquidate the assets of the plan. Upon completing the process of liquidation he shall thereafter submit to the Corporation, within such period specified by regulation of the Corporation, a plan termination report. Such report shall fully disclose the amount of the vested benefit payable to each person under the terms of the plan as of the date the plan was terminated, the amount realized from liquidating assets, the aggregate amount of funds needed to purchase single premium annuities to provide the vested benefit to which each person is entitled under the terms of the plan, and such additional information as may be prescribed by rules of the Corporation. Upon receipt of the plan termination report, the Corporation shall direct the purchase of annuities or authorize the implementation of such other approved arrangement for distributing vested benefits, and pay the claim for insurance in the amount authorized under this Title.

SEC. 304. PAYMENT OF CLAIMS

The amount of insurance payable under a valid claim shall be the difference between the realized value of the assets of the plan and the amount of vested liabilities, limited to the amount of insurance determined under section 301 at the time the plan was terminated; provided that,

a) in any case where a plan would be entitled to relief under section 502 of this Act with respect to meeting the funding ratio specified in section 201 (*a*) (2) if it were not terminating, such relief may be accorded to the plan upon termination and the amount of insurance to be paid shall be adjusted to take into account the relief so provided; except that no relief in this connection shall be accorded where the only basis presented for such relief is a decline in the value of the assets of the plan;

b) in any case where Pension Benefit Insurance Corporation is unable to recover any contributions or portions thereof owing to a terminating pension plan to meet the funding ratio specified in section 201 (*a*) (2), the amount of insurance to be paid shall be adjusted to take into account such unpaid contributions.

c) in any case where a plan is terminated as the result of the closing of a plant of an employer contributing to such plan and the vested liabilities of such terminated plan are less than 20 percent of the vested liabilities of all the pension plans maintained by such employer, such employer shall be liable to reimburse the Pension Benefit Insurance Corporation for any insurance paid by the Corporation in satisfaction of a claim presented by such terminated plan, and the Corporation is authorized to sue such employer to recover the amount of any unpaid liability lawfully payable under this provision.

SEC. 305. UNINSURED PLANS

It shall be unlawful for any administrator of a plan subject to this Title to maintain or operate such a plan without the certificate of insurance required by this Title.

TITLE IV—PENSION BENEFIT INSURANCE CORPORATION

SEC. 401. CREATION OF PENSION BENEFIT INSURANCE CORPORATION

There is hereby created a Pension Benefit Insurance Corporation (hereinafter referred to as the "Corporation") which shall insure the vested liabilities of pension plans subject to Title III. Such corporation shall be an agency and instrumentality of the United States, within the Department of Labor, subject to the general supervision and direction of the Secretary of Labor. The principal office of the Corporation shall be in the District of Columbia but there may be established agencies or branch offices elsewhere in the United States under rules and regulations prescribed by the Corporation.

SEC. 402. GENERAL POWERS OF CORPORATION

The Corporation–

a) Shall have succession in its corporate name.

b) May adopt, alter and use a corporate seal, which shall be judicially noticed.

c) May enter into and carry out such contracts or agreements as are necessary in the conduct of its business.

d) May sue and be sued, in any district court of the United States or its territories or possessions or the Commonwealth of Puerto Rico, which courts shall have exclusive original jurisdiction, without regard to the amount in controversy, of all suits brought by or against the Corporation.

e) May adopt, amend and repeal bylaws, rules and regulations governing the manner in which its business may be conducted and the powers vested in it may be exercised.

f) Shall be entitled to the use of the United States mails in the same manner and upon the same conditions as the executive departments of the Federal Government.

g) Shall have power when necessary to carry out the provisions of Title III, to make investigations and in connection therewith to enter such places and inspect such records and accounts and question such persons as the Corporation may deem necessary to determine the facts relative thereto. For the purpose of any investigation provided for herein, the provisions of sections 9 and 10 (relating to the attendance of witnesses and the production of books, papers, and documents) of the Federal Trade Commission Act of September 16, 1914, as amended (15 U.S.C. 49, 50) are hereby made applicable to the jurisdiction, powers, and duties of the Corporation or any officers designated by the Corporation.

h) Shall determine the character of and the necessity for its obligations and expenditures and the manner in which they shall be incurred, allowed and paid, subject to provisions of law specifically applicable to wholly owned government corporations.

i) Shall have such powers as may be necessary or appropriate for the exercise of the powers specifically vested in the Corporation and all such incidental powers as are customary in corporations generally.

SEC. 403. SPECIFIC POWERS OF CORPORATION

In the fulfillment of its purposes and in carrying out its annual budget programs submitted to and approved by the Congress pursuant to the Government Corporation Control Act, the Corporation is authorized to use its general powers in accordance with the provisions of Title III of this Act to—

a) Establish adequate premium rates to cover the insurance of vested liabilities of private pension plans and the administrative expenses of the Corporation. In determining such premium rates, the Corporation shall consult with the Technical Advisory Committee on Pension Benefit Insurance established by section 405.

b) Establish procedures for the application, renewal and cancellation of insurance, including the prescribing of such forms and reports as may be necessary or appropriate to implement such procedures.

c) Collect premiums and manage and invest the funds of the Corporation.

d) Adjust and pay claims for insurance under rules prescribed by the Corporation.

e) Conduct research, surveys and investigations relating to pension plan insurance and assemble data for the purpose of establishing sound bases for insurance.

f) Bring an action in the proper district court of the United States or United States court of any place subject to the jurisdiction of the United States, to enjoin any acts or practices that constitute or will constitute a violation of Title III or IV or of any regulation or order issued thereunder, or obtain any other appropriate relief, and the United States district courts and the United States courts of any place subject to the jurisdiction of the United States shall have jurisdiction for cause shown, to restrain violations of Title III or Title IV and provide for any other appropriate relief.

g) Carry out such other functions as are required by this Act and as Congress may specifically authorize or provide for.

SEC. 404. PENSION BENEFIT INSURANCE FUND

a) There is hereby created within the Treasury a separate fund for pension benefit insurance (hereafter in this section called "the fund") which shall be available to the Corporation without fiscal year limitation for the purposes of this Title.

b) There is hereby authorized to be appropriated such sums as are necessary to provide capital for the fund. All amounts received as premiums and any other moneys, property or assets derived from operations in connection with this Title shall be deposited in the fund.

c) All claims, expenses and payments pursuant to operation of the Corporation under this Title shall be paid from the fund. From time to time, and at least at the close of each fiscal year, the Corporation shall pay from the fund into the Treasury as miscellaneous receipts interest on the cumulative amount of appropriations provided as capital to the fund, less the average undisbursed cash balance in the fund during the year. The rate of such interest shall be determined by the Secretary of the Treasury, taking into consideration the average market yield during the month preceding each fiscal year on outstanding marketable Treasury obligations. Interest payments may be deferred with the approval of the Secretary of the Treasury, but any interest payments so deferred shall themselves bear interest.

SEC. 405. BOARD OF DIRECTORS: TECHNICAL ADVISORY COMMITTEE

a) The management of the Corporation shall be vested in a Board of Directors (herinafter referred to as the "Board"). The Board shall consist of the Secretaries of Labor and Commerce ex officio and three other Directors appointed by the President by and with the advice and consent of the Senate. The President shall designate a Chairman of the Board from among the three Directors he appoints. Of the first three Directors, one shall be appointed to serve for a term of 2 years; one shall be appointed to serve for a term of 4 years; one shall be appointed to serve for a term of 6 years. Thereafter, upon the expiration of the term of office, each succeeding Director shall be appointed to serve for a term of 6 years. Not more than three of the members of such Board of Directors shall be members of the same political party. Each appointed Director shall receive compensation at the rate of $150 per diem when engaged in the actual performance of duties of the Board, and may be allowed travel expenses, including per diem in lieu of subsistence, as authorized by 5 U.S.C. 5703 for persons in the government employed intermittently, except that any such Director who holds another office or position under the Federal Government shall serve without additional compensation. A majority of the directors shall constitute a quorum of the Board and action shall be taken only by a majority vote of those present.

b) In addition to the Board of Directors there shall be a Technical Advisory Committee on Pension Benefit Insurance which shall consist of five members to be appointed by the Secretary after consultation with the Secretary of Commerce, to advise and consult with the Corporation with respect to carrying out the purposes of this Title. The Secretary shall select for appointment to the Committee individuals who are, by reason of training or experience or both, familiar with and competent to deal with, problems involving employees' pension plans and problems relating to the insurance of such plans. Members of the Committee shall be appointed for a term of two years. Members shall be compensated at the rate of $100 per day for each day they are engaged in the duties of the Committee and, while serving away from their homes or regular places of business, may be allowed travel expenses, including per diem in lieu of subsistence, as authorized by 5 U.S.C. 5703 for persons in the government employed intermittently. The Committee shall meet at Washington, District of Columbia, upon call of the Chairman of the Board of Directors who shall serve as Chairman of the Committee. Meetings shall be called by such Chairman not less often than twice a year.

SEC. 406. PERSONNEL OF CORPORATION

The Corporation shall appoint and fix the compensation of such officers, attorneys and employees as may be necessary for the conduct of its business in accordance with the provisions of title 5, United States Code, governing appointment in the competitive service, and chapter 51 and subchapter III of chapter 53 of such title relating to classification and General Schedule pay rates, and may obtain the services of experts and consultants in accordance with section 3109 of title 5, United States Code, at rates for individuals not to exceed the per diem equivalent for GS-18.

SEC. 407. COOPERATION WITH OTHER GOVERNMENTAL AGENCIES

The provisions of section 509 shall be applicable to the Corporation.

SEC. 408. INVESTMENT OF FUNDS

All money of the Corporation, except appropriated funds, may be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States.

SEC. 409. TAX EXEMPTION

The Corporation, including its franchise, its capital, reserves, and surplus, and its income and property shall be exempt from all taxation imposed by any State, county, municipality or subdivision thereof, except nothing herein exempts from taxation any real property acquired and held by the Corporation.

SEC. 410. RECORDS; ANNUAL REPORT

The Corporation shall at all times maintain complete and accurate books of account and shall file annually with the Secretary of Labor a complete report as to the business of the Corporation, a copy of which shall be forwarded by the Secretary of Labor to the President for transmission to the Congress.

SEC. 411. GOVERNMENT CORPORATION CONTROL ACT

The provisions of the Government Corporation Control Act (59 Stat. 597, 31 U.S.C. 841), as applicable to wholly owned government corporations shall be applicable to the Corporation.

TESTIMONY OF THOMAS R. DONAHUE*

PLAN TERMINATION PROTECTION

Under present regulations an employer has no legal obligation to pay expected pension benefits upon termination of the plan beyond those which can be provided by his previous contributions. The proposed funding standards would prove extremely helpful in assuring that in the future adequate assets will be on hand to meet a plan's vested obligations. However, no funding standard can be expected to provide complete protection from the day of the adoption of this legislation in the event of termination since this would require full and immediate funding of all vested benefits.

To meet the problem of insufficient assets upon termination, a system of plan termination protection is proposed. The aim of such a program would be to provide protection during the early years in the life of a plan before it has been able to build sufficient resources to meet the 100 percent goal. Plan termination protection would also serve the same purpose following amendments which liberalize plan benefits and which also typically require a period of time to become fully funded.

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* Assistant Secretary of Labor before Subcommittee on Labor of Senate Committee on Labor and Public Welfare on Welfare and Pension Plan Protection Act (S. 1024) and the Pension Benefit Security Act (S. 3421), July 25, 1968.

Information on plan terminations, while not complete, does indicate that significant numbers of plan participants are left without their full benefit rights. During the years 1955–65, about 4300 pension plans terminated involving 255,000 employees. Forty-four percent of these terminations occurred under circumstances—financial difficulties or dissolutions of the business—where losses were likely. Currently, about 500 pension plans involving 25,000 employees terminate each year. The well-known experience of the Studebaker employees when that firm closed down its South Bend, Indiana, assembly plant in 1964 is only the most graphic example of what can happen when a terminating plan does not have sufficient assets to meet all vested benefits.

The proposed system of plan termination protection would build directly upon the termination funding standard. It has been developed with the aim of providing full protection for the vested rights of plan participants in the event of plan termination caused by shutdown of operations or adverse economic circumstances.

Essentially, this system is comprised of the following interrelated aspects:

1. Plans would purchase insurance to guarantee payment of vested benefits in the event of plan termination caused by shutdown of operations or adverse economic circumstances.

2. The insurance fund would fully protect vested benefits of all plans satisfying the funding standard.

3. Plans that do not meet the termination funding standard would not be permitted insurance coverage for the amount by which their assets fell short of the amounts required by the standard, but rather in these instances the employer would be liable for this amount.

4. Conditions under which claims against the insurance fund are honored would be carefully limited in order to maintain the integrity of the insurance fund.

Administrative arrangements for handling the insurance fund will be based on the funding status reports to be submitted every three years. These reports will provide the information necessary to calculate the amount of insurance required and the premiums to be paid. The amount of insurance required is essentially the difference between the plan's vested liabilities (its obligations in the event of termination) and the greater of 1) the assets on hand, or 2) the assets required to be on hand by the funding schedule. Finally, the assets will be valued at 90 percent, rather than 100 percent, of market value in order to provide a uniform limited hedge against possible future loss due to market depreciation of assets. However, I want to make clear that the insurance proposal does not involve any government regulation or supervision of pension fund assets beyond that contemplated in the proposed legislation regarding fiduciary standards for private pension plans (S. 1024).

Premiums would be calculated at a uniform rate on a plan's unfunded vested liabilities. Preliminary calculations indicate that an insurance plan can be financed through contributions averaging not more than 0.2 percent a year of unfunded vested liabilities. S. 3421 sets a maximum rate of 0.6 percent for the initial three-year premium.

Claims against the fund would be honored only in the event of essentially involuntary plan terminations caused by financial difficulty or bankruptcy. More detailed discussion of procedures involved in plan terminations is given in Exhibit C.

In order to protect the insurance fund from possible abuse, a number of specific restrictions have been included in the proposed legislation. Among them are the following:

1. Claims would be honored only upon terminations arising from plant closings that affect 20 percent or more of the vested liabilities of a firm's total pension plans. If less significant terminations were to be covered some employers might fragment their pension plan arrangements to take advantage of the insurance when only a minor rearrangement of their business structure was involved.

2. Claims for vested liabilities arising out of plan amendments would not be honored if the amendment took effect within three years preceding the plan's termination. Unless such a limitation is included, it would be possible to amend a plan shortly before its termination in order to collect additional benefits through the insurance fund.

3. No benefits would be payable to stockholders owning over 10 percent of the value or voting power of the company's stock. Such stockholders typically are in a position to exert major control over the company and its pension plan.

An integral part of the proposed funding-insurance system would be a system of disclosing to plan participants the degree of protection provided them, as indicated by the plan's funding status report required every three years. If the plan's funding was at or above its funding target, the funding status report would simply be made available to each person with vested benefits. If, on the other hand, the plan's funding is below its funding target, each participant with a vested benefit would be informed individually as to that portion of his benefit protected by assets, that portion protected by insurance, and that portion protected by neither but for which the employer is liable in the event of termination.

EXCERPT FROM EXHIBIT C ATTACHED TO TESTIMONY OF MR. THOMAS R. DONAHUE, JULY 25, 1968

A system of plan termination protection will supplement a plan's funding to assure that in the event of involuntary plan termination prior to full funding of vested liabilities, protection will be available to cover the gaps between the plan's actual assets (or funding target, if greater) and the full funding goal.

In developing such a system, the following specific issues have been considered.

PROTECTION TO BE PROVIDED

The bill proposes the establishment of a Federal system of plan termination insurance to be financed by premiums to be paid by plans with unfunded vested liabilities.

In developing an insurance system, an important issue considered was whether the plan termination insurance fund should make up any deficit of a terminating plan without regard to the employer's financial capability to meet some or all of the plan's unfunded obligations. If the employer was required to make up any deficit, insurance funds would then cover only those situations where the employer was unable to do so. While this approach may have some appeal from a theoretical standpoint and would provide substantial protection against abuse of the fund, its adoption could have a serious impact on the formation or continuation of private retirement plans. It is doubtful that many employers would be willing to assume a legal liability for the pension cost that might occur if they were required to terminate their plan before being able to fund a large past service liability. For this reason, the insurance fund was made available regardless of a firm's financial situation.

At the same time, the insurance system should not operate in a manner that might undermine a plan's incentive to fund. Thus, the interlocking relation of the insurance system with the termination funding standard is of special importance.

For this reason, under the proposed insurance system, a plan would not be able to obtain insurance for any amount by which its funding status fell below the termination funding standard. In the absence of additional protection, if the plan was forced to terminate, the plan participants would be left without full protection of their vested benefits. Since this loss of benefits is directly attributable to the employer's failure to meet the funding standard, it is reasonable in such circumstances to require the employer to assume the liability for this deficiency.

AMOUNT OF INSURANCE COVERAGE

The results obtained by the periodic funding test will be utilized as the basis for setting the amount of plan termination insurance that each plan will be required to purchase. The amounts of required insurance would be set as follows:

1. If 90 percent of the fund's assets exceeded total vested liabilities, no insurance would be required. The 90 percent figure has been selected rather than 100 percent in order to provide some protection against normal fluctuations in the difference between the market value of assets and the value of vested liabilities during the three-year period between funding tests.

2. If 90 percent of the fund's assets are below total vested liabilities but at or above its funding target, the plan would be required to apply for plan termination insurance equal to the difference between 90 percent of its assets and total vested liabilities.
3. If 90 percent of the fund's assets are below its funding target, it would be required to apply for plan termination insurance equal to the difference between its funding target and total vested liabilities. No insurance would be available to cover a plan's unfunded vested liabilities below its funding target. This would, however, become a direct liability of the employer.

METHOD OF ASSESSING PREMIUM

It might be argued that insurance premiums should vary with the type and degree of risks involved; the plans with the greatest exposure should pay the highest premiums. However, in this instance, the practical difficulties of implementing this principle are most formidable. There is no equitable method of identifying among a group of manufacturing firms or public utilities which ones would carry a lower (or higher) risk of termination.

One approach to plan termination insurance would be to vary premiums according to the ratio of unfunded to total vested liabilities so that the higher the proportion of vested liabilities to be insured, the higher the premium rate. However, this system is not proposed because the ratio of unfunded to vested liabilities does not appear to be a reliable indicator of the risk of termination.

The bill requires that plans taking out insurance should pay premiums to an insurance fund equal to a uniform percentage of the amount of unfunded liabilities to be covered.

INSURANCE PREMIUM RATE

Reliable estimates of the appropriate premium rate for pension benefit insurance are difficult to calculate both because of the paucity of data on past experience and the difficulty of developing projections for the future. Estimates of future claims—benefit losses due to involuntary plan termination—are particularly tenuous because the volume of claims would depend on economic trends and fluctuations in a wide variety of industries where pension plans are prevalent. Similarly, available data are not sufficiently precise to provide reliable estimates of unfunded vested liabilities, the base on which premiums are to be assessed.

Some very preliminary calculations are included in the table on the following page.* They show estimated average annual claims of $28 million and unfunded vested liabilities to be insured of $24 billion. Under these circumstances, an annual premium of less than 0.12 percent would provide sufficient revenue for meeting specified claims.

However, to build up reserves as quickly as practicable, to reduce the likelihood of premiums being inadequate to meet claims in the early years, and to cover administrative expenses, the bill specifices that the premium for the first three years will be not more than 0.6 percent of the amount insured, or an annual rate of 0.2 percent.

CONDITIONS UNDER WHICH INSURANCE IS PAYABLE

In developing the proposed insurance system, the aim has been to provide protection to participants from terminations which are forced through adverse economic circumstances. The bill provides that the insurance system can be invoked only if a plan is terminated for "reasons of financial difficulty or bankruptcy, plant closing, by order of the Secretary, or such other reasons as the Corporation (Pension Benefit Insurance Corporation) by regulation shall specify as reflecting an essentially involuntary plan termination."

With reference to the closing down of a specific plant, the bill further provides that if the terminated plan (s) do not cover at least 20 percent of the total vested liabilities of all company pension plans, the insurance fund would have the right to recover from the employer any claims paid. This requirement is necessary to avoid the temptation by multi-plant employers to create individual plans for each section of their operations so that they may collect insurance for even minor changes in their business structure. In these situations, the employer is treated as though he has only a single pension plan.

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* See p. 178.

PROCEDURE FOR PAYMENT OF CLAIMS

Upon termination, the individual plan would be required to file a claim with the Pension Benefit Insurance Corporation, including information necessary for determining the extent of any liability to be assumed by the insurance fund or the employer. This would include a requirement that the terminated plan take the funding test. This test would reflect the funding position of the plan after any variance to which the plan might be entitled at the time of termination.

After reviewing the claim and making any independent investigation that it deemed necessary, the Corporation would determine the validity of the claim and notify the administrator of its decision. If the claim is honored, the Corporation would direct the purchase of annuities or authorize other arrangements for distributing vested benefits.

The amount payable from the insurance fund as previously indicated, would be limited to the difference at the time of termination between vested liabilities and the greater of the plan's assets or the funding target. The employer would be liable for any contributions necessary to meet the termination funding standard. However, the amount of claim payable by the insurance fund would be increased if these contributions could not be recovered (e.g., in event of bankruptcy).

PROTECTION FOR THE INTEGRITY OF INSURANCE FUND

In order to protect the insurance fund from possible abuse, a number of specific restrictions have been included in the proposed legislation. Among them are the following:

1. Claims would be honored only upon essentially involuntary terminations. Regulations by the Corporation would implement this requirement.
2. In the case of terminations resulting from plant closings, the insurance fund, as previously indicated, would have the right to recover from the employer any claims paid in situations where the terminating plan did not affect 20 percent or more of the vested liabilities of all the firm's pension plans.

Estimate of Annual Premium Rate Required to Meet Expected Claims under Pension Benefit Insurance

Expected Claims Experience

A. Average annual number of participants in terminated pension plans, 1955–65	20,500
B. *Less* participants in plans in operation for less than 5 years	−6,000
C. Participants in plans in operation for 5 or more years	14,500
D. Average annual number of participants losing vested benefits in terminated plans	7,000
Reflects adjustment of line C for three factors: Participants who suffered no loss or small losses because they were given substantially similar rights in the plan of a merging or purchasing company, employees without vested rights because they have less than ten years of service, and participants who received their benefits from the plan's assets.	
E. Average discounted present value per claim	$4,000
It was assumed that at termination the average claimant was a male aged 50 who has accrued a benefit of $50 a month commencing at age 65. This is roughly an insurer's single premium charge for assuming such a claim.	
F. Total annual expected claims (D × E)	$28,000,000

Premium Base (Unfunded Vested Liabilities)

Assets

1. Total assets (end of 1967)	$80 billion
The preliminary SEC estimate of $103.4 billion for all private retirement plans at the end of 1967 was adjusted to exclude profit-sharing plans and money purchase plans.	
2. *Less* assets in excess of vested liabilities	−12 billion
For plans with assets greater than vested liabilities, estimated amount of the excess.	
3. Net assets	$68 billion
4. Net assets adjusted for computation of premiums (90% × line 3)	$61 billion

Liabilities

5. Total liabilities	$107 billion
Estimated from (1) on the assumption that, on the average, about three-fourth of the total liabilities are funded.	
6. Vested liabilities	$85 billion
Estimated from (5) on the assumption that, on the average, about four-fifths of the total liability would vest under a 10-year vesting requirement.	
7. Unfunded liabilities to be insured ($85 billion − $61 billion)	$24 billion
Annual premium rate required to pay expected claims (F ÷ 7)	0.12%

3. Claims for vested liabilities arising out of plan amendments would not be honored if the amendment took effect within three years preceding the plan's termination. Unless such a limitation is included, it would be possible to amend a plan shortly before its termination in order to collect additional benefits through the insurance fund.
4. No benefits would be payable to stockholders owning over 10 percent of the value or voting power of the country's stock. Such stockholders typically are in a position to exert major control over the company and its pension plan.

DISCLOSURE OF FUNDING AND INSURANCE STATUS

It seems desirable that any effort to set financial standards should also include procedures for providing plan participants with greater knowledge regarding the financial support behind the stated benefits in their pension plan.

The bill provides that following each occasion on which a plan computes its funding status, the following procedure would apply:

If the plan's funding is at or above its funding target, the plan's funding status report would be made available to each person with a vested benefit.

If the plan's funding is below its funding target, each vested employee would be informed individually with respect to:

1. The amount of his vested benefit under the plan's provisions.
2. The portion of his vested benefit protected by the combination of assets and plan termination insurance which would be provided if the termination provisions of the plan were applied.
3. The proportion of his vested benefit protected by the employer's liability in the event of termination.

Appendix G

Testimony on Private Welfare and Pension Plan Legislation (H.R. 1045 and 1046)

1. TESTIMONY OF I. W. ABEL*

My name is I. W. Abel. I am President of the United Steelworkers of America. I appear here to advocate federal legislation, of the character of H.R. 1045 and H.R. 1046, which would raise the standards of conduct for the fiduciaries of employee pension plans and pension funds; require adequate funding of such plans by employers; provide liberal vested benefits for covered employees; and institute a federal system of reinsurance which would prevent covered employees from losing their retirement incomes because of financial troubles of the employer.

On December 10, 1969, Mr. Andrew J. Biemiller appeared before this Committee on behalf of the AFL–CIO in support of H.R 1045 and H.R. 1046. I would like to associate myself with Mr. Biemiller's statement and to endorse his suggestions for modifications in these two Bills. I do not wish to take the time of the Committee to cover the same ground as Mr. Biemiller. I should like, however, to emphasize some of the points touched on in his comprehensive statement, but which are of crucial importance to Steelworkers.

No trade union in the world has as many members covered by private pension plans as does the United Steelworkers

* President United Steelworkers of America; testimony before the General Subcommittee on Labor House Committee on Education and Labor, Thursday, April 23, 1970, on Private Welfare and Pension Plan Legislation.

of America. We have currently about 1,000,000 of our members who participate under negotiated pension plans varying in many respects. But about 600,000 are subject to plans substantially identical to those in effect in the basic steel industry, and which have also been adopted by many other companies in other areas of our jurisdiction.

NEED FOR REINSURANCE

The Internal Revenue Code places a limit on the contributions of an employer to a pension plan which can be counted as an expense for the purpose of computing federal income tax liability. In general, the Code has the effect of making it necessary to spread the contributions of an employer to cover past service liability over a period of at least 12 to 14 years. This necessity for spreading payments over a period of time applies not only to the initiation of a pension plan, but also to any subsequent improvement of benefits.

As a matter of fact, it is unusal for any employer in our jurisdiction to plan on a funding period as short as 12 years. In some cases the steep rise in interest rates and in equity prices has resulted in funding periods much shorter than was planned. But it is more usual for funding to be scheduled over periods of 25 or 30 years or, in some incidents, an even longer number of years. And under the minimum standard incorporated in the Internal Revenue ruling to which I referred, funding is scheduled, in effect, in perpetuity.

In the industries in which collective bargaining has played a major role, pension agreements began to be initiated on a large scale about 20 years ago. For these 20 years we have been both extending plans to members for the first time and improving plans already in operation. This process would not end even if the consumer prices were to be stabilized at the present level. If prices continue to rise, we shall always be updating our pension plans. And at each updating there will be more liabilities to be covered by contributions spread over a period of years.

This expansion of liabilities means, of course, that there will always be liabilities not covered by accumulated reserves even if each increment of liability is scheduled for funding over a short term of years. If the employer goes out of business or, while continuing in business, has to terminate the plan because of financial inability to make the contributions, the accumulated reserves will fall short of meeting the liabilities.

As I have said, we have had many cases in which pension plans we have negotiated for our members have been terminated because, as in our first case history, new competition has taken away business from the sponsoring employer and for other reasons. More such occurrences are to be anticipated. In most of these cases in the past the pension plan assets, as in the case history, fell short of the liabilities. This also will continue to be the case.

We occasionally have the pleasant experience of dealing with an over-funded plan. About a year ago, the operations covered by one of our pension agreements were discontinued entirely less than 12 months after the company, despite the limitations of the Internal Revenue Code, had, by a single large contribution, completely funded its past service liability. No doubt it will be another 20 years before that particular incident is repeated.

Most of the businesses which cease to exist do not do so voluntarily. Like the company in our case history, they are forced out by competition which they are unable to meet. The economy as a whole may, and usually does, benefit from the inventions and the initiative which produce disaster for the organization which is displaced. It is reasonable that the losses be spread over the whole economy, which, in essence, is the area in which private pension plans now operate.

The means by which this spreading is accomplished is insurance, and the steps by which H.R. 1045 proposes to initiate a system of insurance I wholeheartedly endorse in principle. But insurance should be coextensive with the funding which, as I have indicated, should cover the entire liabilities. I wish to reemphasize the statement made on behalf of the AFL–CIO that "as a means of reducing the premium cost of a Federal insurance benefit program . . . where an employer is forced out of business, the bankruptcy laws should be amended to provide that a health, welfare or pension plan should have a priority claim against the assets of the employer."

Further, where the terminating operation is owned by a corporation which continues in operation, consideration should be given to assessing the liability against the owning corporation and not the pension insurance corporation. This may be done by means of a mandatory guarantee (such as I described in my first case history), or by such other appropriate means as the pension insurance corporation directors might prescribe under proper statutory authority.

If a pension plan and trust which have been operating for many years—for the last 3 years without an amendment—were to be divided into two, I see nothing in H.R. 1045 which would preclude either of the two successor plans being insured immediately. Thus, if one of the plans were to terminate because of a plant shutdown, for example, the burden of unfunded liabilities under that plan would fall on the pension insurance corporation. However, if there had been no division, the burden would fall on the undivided pension plan and trust.

Nor is there anything to prevent the fund from being split in such a way that one plan is implemented by a trust fund with a 100 percent assets/liabilities ratio, and the other with assets which are a small fraction of the liabilities. Yet, to require equity in the division of the funds between successor plans will not fully remedy the situation.

Because the possibility exists of dividing a single plan or fund into two or more plans, there can be unanticipated drains on pension insurance funds. No previous experience with pension plan terminations will have any bearing whatever on the premiums required to provide assurance to employees that all pension obligations will be met under H.R. 1045 as it now is formulated.

I urge that H.R. 1045 be revised so as to preclude any division of pension funds which has the effect of creating a drain on the assets of the Pension Benefit Insurance Corporation greater than would have occurred if there had been no such division.

I have not mentioned many faults of present pension plans but I hope I have described enough of our problems to indicate that they are serious and urgent. Remedial legislation ought to be given the highest priority.

2. TESTIMONY OF H. C. LUMB*

PLAN TERMINATION INSURANCE

Plan termination insurance is proposed in H.R. 1045. A Department of Labor study shows that the number of pension plan terminations is miniscule, affecting only one-tenth of one percent of persons covered by private pension plans. These so-called terminations include mergers of pension plans with continuation of pension coverage, and most of the terminated plans in the study were so new that there would not have been any vested benefits under any current vesting proposal.

NAM believes that the plan termination insurance proposal to deal with this miniscule problem is inequitable, unnecessary and undersirable for the following reasons:

1. The proposed standards as applied to plan termination insurance would involve centralized control of all pension plan financing, actuarial assumptions and investment policy. Otherwise, some employers would have an incentive to minimize funding and pass the risk to other employers. Plan amendments would have to be regulated and controlled in order to prevent unwarranted increases in benefit obligations inconsistent with an employer's fiscal responsibility.

2. Under a program of plan termination insurance, some plan administrators might be encouraged to make some speculative investments since the risk would be borne by other pension plans. Similarly, the case of negotiated pension agreements, there would be a tendency for the parties to negotiate unduly liberal benefits since again the risk would be borne by other pension plans.

3. A business operation may terminate as a result of bankruptcy, seriously declining operations, or other such reasons. That is not an insurable risk and it would not be feasible in any event

* Mr. Lumb represented the National Association of Manufacturers on H.R. 1046, The Welfare and Pension Plan Protection Act of 1969, and H.R. 1045, The Pension Benefit Security Act before the General Subcommittee on Labor of the House Committee on Education and Labor, March 18, 1970.

to vary premiums appropriately with the assumed risk of different businesses.

4. An essential element in any insurance is that the risk insured against be beyond the control of the insured. The insurance of pension expectations would be within the control of the insured in three important areas. First, the pension expectations are determined by the employer, which at the outset are based on nothing more than a statement of intent. Even such an important matter as the crediting of service rendered prior to the establishment of the plan would be within the discretion of the insured. Second, the insured would determine in many instances whether a certain business operation could be continued. Thus, the insured could control both the establishment and the amount of insured liability, as well as the event which results in the payment of the liability. Third, the insured determines investment policy which would have an important bearing on the amount of the liability.

5. If pension plan insurance were to discourge the extent of funding as we believe it would, this might lead to a greater number of plan terminations. The resulting higher cost of subsidizing the terminating plans would adversely affect the soundness of the remaining plans.

6. The proposed plan termination insurance program would lead to pressure for fixed standards to measure the liability insured, to assure adequate funding and safe investment practices, and even to fix benefits. Such standards would not only fail to accomplish these purposes, but would be inappropriate and incorrect for any particular plan. They would remove the flexibility which is essential to the continued sucess of existing plans and to the establishment of new plans.

7. Any comparison with federal bank deposit insurance is not valid because FDIC insures assets in being, while pension benefits are to be paid in the future out of contributions which may not yet have been made.

CONCLUSION

We believe that in order to encourage and sustain the continued growth of private pension plans which have contributed so much to our national economy and to the retirement security of millions of people, independence of action and flexibility are absolutely essential. Rigid formulas imposed by laws, would discourage the establishment of new plans and increase the cost of existing ones.

NAM will continue to support the development and improvement of private pension plans to provide adequate benefits for retired workers, and the expansion and liberalization of existing ones. NAM endorses the concept of fiduciary responsibility and adequate disclosure and, therefore, supports H.R. 1046 with the modifications suggested.

Appendix H

Reinsurance

*By the Committee on Employee Benefits of the Financial Executives Institute**

If a pension plan is terminated, the liability of the employer is often limited to the plan assets on hand. It is possible that the assets at the time of termination may not be sufficient to pay all of the accrued benefits. This situation would be most likely to occur in a relatively new plan or in a plan under which benefits had been recently improved. When a new plan is installed or an existing plan improved, the liabilities for benefits for service already rendered may be sizeable. A company's over-all cash needs may require that these liabilities be funded gradually over a period of time. In addition, the Internal Revenue Code places limitations, as previously noted, on the amount of pension plan contributions that are deductible for tax purposes.

Proposals have been made for the establishment of a Federal insurance program, commonly referred to as "reinsurance," to make up for any loss of benefits due to an insufficiency of assets in the event of termination of a private pension plan. A pension insurance program for qualified plans presumably would operate as follows:

1. The amount at risk would be defined as the difference between the value of benefits for service to date and the value of the assets at hand.
2. Premium rates would be set.

* Section on Reinsurance from the Monograph, *Private Pension Plans and the Public Interest,* prepared by the Committee on Employee Benefits of the Financial Executives Institute, October, 1967.

3. The product of (1) and (2), for any given plan, would be contributed to an insurance fund.

4. When a pension plan termination occurs and an employer is not able to continue contributions, any asset deficiency would be made up out of the insurance fund. Possibly the insuring agency would take over the assets of the plan at termination and then undertake to provide the benefits out of the insurance fund.

The idea of insuring pension obligations might at first glance appear to have considerable appeal. Failure to receive anticipated pension benefits unquestionably would be a serious financial loss to plan participants and their beneficiaries. Certainly it would be desirable to be able to assure employees that they need not be concerned about loss of pension benefits. From the employer's standpoint, the availability of insurance might seem to relieve him of the responsibility for setting aside adequate assets to meet pension obligations when they become due.

Insurance would not, however, avoid the necessity to have adequate cash to meet pension obligations. It would merely transfer this responsibility from individual employers to the insuring agency. Thus, the only advantage of an insurance program for private pension plans would be the spreading of the risks among a large number of employers.

However, there are several aspects of a pension insurance program which should also be given careful consideration. Defining the amount at risk would require exceedingly complex rules and regulations, particularly for plans which do not grant a specific benefit for each year of service or for plans with formulas under which Social Security is deducted. It would seem that actuarial assumptions and valuation procedures would have to be specified and standardized by the Government. Funding practices would probably require centralized control; otherwise, some employers would have an incentive to minimize funding and pass the risk to other employers. Plan amendments would have to be regulated and controlled in order to prevent unwarranted increases in benefit obligations, for example, prior to termination of a plan.

If uniform funding requirements were established, they would further reduce the employer's choice in the timing of his contributions and might discourage the adoption of new plans. Rigid requirements may also lead companies to put all or part of their programs on an unfunded, pay-as-you-go basis, leaving the employees both insecure and uninsured. Consideration also should be given to the penalties which would apply if an employer failed to meet the funding schedule. Can a distinction be made between insufficient contributions and unwise investment decisions? If not, will the insurance also cover the risk of investment loss? And will this lead employers to make speculative investments, the risk to be borne by the insurer or other pension plans?

Difficulties also arise in determining a proper premium structure. A conservative schedule might unduly impede the growth and liberalization of plans. In the absence of valid statistics and a clear definition of the risk insured against, however, the initial premiums would have to be set high. The alternative to high premium rates would be Federal underwriting of the insurance program out of the general revenues.

Should the premium rate be the same for all companies? If the rates vary for each class of company, what criteria should be used to measure the extent of risk in each case? Obviously the risk of termination is much smaller for some employers than others. Should strong companies be burdened to take care of the marginal companies? If so, what is to prevent a strong company from funding its own benefits, thereby avoiding any subsidy to the insurance system? Would not the progressive elimination of the strong employers from the system in time lead to increased premium charges on the weaker companies and place them at a further competitive disadvantage in the labor market?

There can be no disagreement that avoidance of unexpected loss of pension benefits is a desirable objective. However, an insurance program administered by the Federal government on a mandatory basis for all employers would drastically decrease the flexibility which is such an important feature of the private pension system. Extensive and complex Federal regulations probably would be required to assure uniformity of actuarial assumptions, investment programs, asset valuation and funding practices. In short, it is not possible for private pension plans to be tailored to meet the characteristics and needs of individual companies and groups of employees and also meet uniform insurance requirements.

The Committee believes that a Federal pension insurance program would be costly, impractical and unnecessary. The regulatory requirements of such a program would seriously impinge upon the operations of private pension plans. It would be preferable to place greater emphasis on (a) adequate funding within each private plan and (b) full disclosure to plan participants regarding the extent to which benefit obligations have been provided for through accumulation of fund assets.