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SUMMARY OF TESTIMONY ON PROPOSALS TO AMEND ERISA

PREPARED FOR THE USE OF THE

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SUMMARY OF TESTIMONY ON PROPOSALS TO AMEND THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

The Subcommittee on Private Pension Plans of the Senate Committee on Finance, together with the Senate Select Committee on Small Business, held joint hearings on proposals to amend the Employee Retirement Income Security Act of 1974. The hearings were held May 10, 11, 24, 25, June 28, and July 18, 1977 on two proposals introduced by Senator Bentsen (S. 285, the "Tax-Exempt Private Pension Investment Act of 1977," and S. 901, the "Pension Simplification Act") and a proposal by Senator McIntyre and Senator Nelson (S. 1745, the "ERISA Small Business Paperwork Reduction and Investment Act"). Summarized below are the statements of witnesses at the public hearings on these proposals.

This summary was prepared with the assistance of the Congressional Research Service: Ray Schmitt and Ethan Minsky.

Hon. Laurence N. Woodworth, Assistant Secretary of the Treasury for Tax Policy (May 10)

Pension Simplification Act

Points out that there are parallel provisions under the tax and labor law portions of ERISA regarding participation, vesting, and funding. Feels that perhaps the most troublesome area of dual jurisdiction has come up in connection with prohibited transactions. Believes that S. 901 offers a legislative solution to the problem of dual jurisdiction by eliminating any overlapping responsibility within Labor, the Internal Revenue Service (IRS), and the Pension Benefit Guaranty Corporation (PBGC). Points out that both Treasury and Labor are presently studying the problems which have been created by dual jurisdiction under titles I and II of ERISA, and are working toward a joint recommendation in this area which is expected later this year. Based upon their preliminary analysis, the Treasury Department believes that dual jurisdiction should be eliminated through a clear assignment of responsibility. The joint recommendation is likely to differ somewhat from the provisions of S. 901 as to the assignment of responsibility. Considers it to be premature to discuss specific assignments of responsibility in detail. The Treasury Department believes the reorganization should give strong consideration to allowing each agency to continue to develop its strongest area of competence under ERISA and prior law. Indicates that to set up a brand new agency would be to neglect all the experience and lessons that have been learned in the development of the existing plans by the Departments of Labor and Treasury and would be the best way to assure that the uncertainty continues for an indefinite time ahead.

Believes that a more orderly set of reporting requirements could be developed if a single annual report had to be filed only with the IRS. This would eliminate the duplication of effort involved in filing the same form with both agencies.

The Treasury Department also questions giving Federal district courts the right to issue declaratory judgments when Labor, IRS, or PBGC failed to act with respect to an employee benefit plan in a matter arising under ERISA. Points out that as a result of ERISA, the Tax Court already has the authority to issue a declaratory judgment relating to the qualification of retirement plans and that the addition of declaratory judgment authority in other areas would seriously hinder the administrative process.

Tax-Exempt Private Pension Investment Act of 1977

In principal the Treasury Department agrees with the "concentration rule" in S. 285. However, to the extent that concentration in the stock market is a problem, it appears to Treasury that the problem should be addressed not simply in the context of pension funds. Also, it would appear that the issue of an institutional investor's domination of trading in a stock may more appropriately be the concern of the Securities and Exchange Commission. The Treasury Department supports efforts to encourage capital formation but continues to believe that the concept of prudence should govern conduct of employee benefit plan fiduciaries, including the extent to which they invest plan assets in new venture capital formations.

Hon. Francis X. Burkhardt, Assistant Secretary of Labor for Labor-Management Relations (May 10)

Pension Simplification Act

Indicates that the objectives of S. 901 are sound. Believes there is a real need to clearly define areas of responsibility. Feels that tax questions rightly belong in the Treasury Department. Points out that the Labor Department has had almost twenty years of experience under the Welfare and Pension Plans Disclosure Act. States that the Labor Department and the Treasury Department can work out and sort out some of the areas of responsibility.

Tax-Exempt Private Pension Investment Act of 1977

Not sure whether S. 285 will really result in breaking up economic concentration. Indicates that the question may be a better one for the Securities and Exchange Commission.

Donald C. Alexander, Attorney, New York, N.Y.; Former Commissioner of Internal Revenue (May 11)

Pension Simplification Act

Supports S. 901. States that there is a problem with dual jurisdiction. Feels that a legislative solution has become necessary; however, maintains that the legislation should not disregard the accumulated experience, staff, and knowledge acquired by the IRS over the past thirty years in administering predecessor provisions of law and current provisions in respect to retirement plans. Considers the pension system to be inextricably tied to our system of taxation. Asserts that the creation of a massive new agency will not solve the problems of jurisdictional overlap and duplication. Feels that the soundest way to proceed is to eliminate the overlapping jurisdiction by the allocation of responsibilities between IRS and the Department of Labor. Believes that the IRS should be assigned the functions of participation, vesting, and funding.

William J. Chadwick, Attorney, Los Angeles, Calif.; Former Administrator of Pension and Welfare Benefit Programs, Department of Labor (May 11)

Pension Simplification Act

Believes there is a need for a more comprehensive solution to dual jurisdiction than that embodied in S. 901. Feels that S. 901 solves only part of the problem. Asserts that the proliferation of laws relating to employee benefits and the burgeoning bureaucracy has led to an incredibly complex regulatory network beyond the comprehension of most people. Considers this problem to be far greater than dual jurisdiction over ERISA. Contends that there is no Federal policy consistently applied to all retirement income programs.

Tax-Exempt Private Pension Investment Act of 1977

Maintains that ERISA has had a chilling effect on the acquisition and disposition of securities by pension plans. Believes that the overly conservative pension plan investment policies are a result of the failure to properly understand ERISA's fiduciary provisions. Feels ERISA is flexible enough to accommodate the modern portfolio theory.

Richard H. Fay, Attorney, Washington, D.C. (May 11)

Pension Simplification Act

States that the present administration of ERISA is unworkable. Considers S. 901 a commendable effort to get some clarity into the administration of ERISA, and generally supports it for that reason. However, feels the best long-term solution is to have only a single independent agency. Indicates that this would call for the transfer of IRS personnel in order to get the best expertise. Comments that the single agency approach can not be accomplished overnight; therefore, that is one of the advantages inherent in S. 901.

National Venture Capital Association, David T. Morgenthaler, President (May 11)

Tax-Exempt Private Pension Investment Act of 1977

Expresses concern about the damage that is being done to smaller businesses and the jobs that are not being created as a result of the unintended side effects of ERISA. Believes that much of the reason for this is the prudent man interpretation of ERISA. Feels that S. 285 will improve the situation.

Richard J. Hanschen, Dallas, Tex. (May 11)

Tax-Exempt Private Pension Investment Act of 1977

Believes that pension plan investments only in mature companies (such as pension funds managers have interpreted ERISA) may not be taking unusual risks; however, feels that the passage of time will turn their mature investments into declining situations with rapidly eroding market values.

Stewart Greenfield, Darien, Conn. (May 11)

Tax-Exempt Private Pension Investment Act of 1977

Feels that S. 285 is an antidote for the consequences of the great risk and the vagueness of the prudent man rule as expressed in ERISA. States that since the passage of ERISA, pension funds have made virtually no investments in venture capital.

Reid Dennis, San Francisco, Calif. (May 11)

Tax-Exempt Private Pension Investment Act of 1977

Believes that section 2 of S. 285 should be revised to change the words "5 percent of any class of security" to read "5 percent of the voting securities" or "5 percent of the equity securities." Supports modification of the prudent man rule but believes the two-percent lee-way clause should be based upon the cost of the assets rather than market value. Stresses the fact that section 3 of S. 285 is a permissive piece of legislation and does not force anyone to follow the practices outlined.

Bruce G. Fielding, CPA, Secretary, National Federation of Independent Business and Member of the Commission on Federal Paperwork (May 24)

Pension Simplification Act

Considers S. 901 to be preferable to legislation which would create a new agency, states that S. 901 will attempt to correct a glaring defect in ERISA by establishing a clear division of authority between IRS and the Department of Labor. Comments that the proposed amendment to section 103 of ERISA should make a distinction between plans with less than 100 participants and large plans and should specify the information required of these small plans. Feels that one report for all should be sufficient, as it may not help to file the Form EBS–1 with the Department of Labor and Form 5300 with IRS. Maintains that a single copy of the adoption agreement should be sufficient for all concerned parties.

Believes the 60-day gestation period for the proposed annual report form is not realistic. Prefers that S. 901 specify that the Act would become effective 60 days after regulations are finalized and that IRS and the Department of Labor must finalize these regulations within 90 days after enactment. Believes that relief from the requirement of obtaining a formal determination letter for small plans is needed. Recommends the statutory creation of a small business retirement plan advisory committee which would act in an advisory capacity to both IRS and Labor.

William Goldstein, Attorney, Former Deputy Assistant Secretary of the Treasury for Tax Policy (May 24)

Pension Simplification Act

Regarding the overlapping jurisdiction of IRS and the Department of Labor, prefers the approach outlined in S. 901 over the single agency approach because it is superior in terms of simplicity, rapid effectiveness, and political reality. States that if the lapse in coverage of non-qualifield plans is unintentional, S. 901 should be amended to provide for coverage under the jurisdiction either of the Department of Labor or IRS. However, feels that choosing the Labor Department would seem inconsistent with the general policy of transferring jurisdiction over participation, vesting, and funding to IRS.

Indicates that prohibited transactions are best dealt with by a single agency and that such agency should be the Department of Labor. Questions how well new section 3004(c) of ERISA would function. Strongly supports the provisions in S. 901 which prescribe a single form and single annual filing date for certain reports required under ERISA. Feels that S. 901 is definitely a step in the right direction in reducing the complexities and delay in administration of ERISA and in reducing the paperwork burden resulting therefrom.

Tax-Exempt Private Pension Investment Act of 1977

Although he strongly advocates encouraging venture capital and investment in smaller companies, he does not believe that the best way to accomplish this is by encouraging fiduciaries to be less prudent with even two percent of the assets upon which employees rely for their pensions. Rather, he prefers to see other incentives for smaller companies, both inside and outside the tax law, so that investments in such businesses can be made by pension funds because they are indeed prudent.

National Association of Small Business Investment Companies, Walter B. Stults, Executive Vice President (May 24)

Tax-Exempt Private Pension Investment Act of 1977

Concludes that ERISA has had a serious adverse impact on small business. Although he fully endorses the goals of ERISA, he feels that the language of the Act and its ramifications have brought forth severe dislocations. Points out that where section 3 of S. 285 deals with companies with a capitalization of $25 million or less, there may be a vast no man's land between the $25 million and billion dollar corporations. Points out further that the leeway clause in S. 285 is not mandatory and if a pension fund manager does not want to invest in any venture capital funds or in any growth stocks there is nothing forcing him. Also, notes that this is not a new concept since a five percent leeway clause has been practiced for many years by insurance companies without protest.

American Society of Pension Actuaries, William C. Spencer, President (May 24)

Pension Simplification Act

Endorses S. 901, since he believes it will do much to relieve the present confusion surrounding minimum standards and prohibited transactions. However, he believes it will only constitute an interim step in the process of solving the multiple jurisdiction problem. Feels that S. 901 will provide an effective short-term solution to the problem but that more drastic measures must be taken if the private pension system is going to continue to expand at a rate necessary to meet the needs of the American public.

Asserts that the only satisfactory long-term approach is total consolidation of the pension regulatory process in a single regulatory agency. Feels certain that S. 901 will provide short-term relief but does not believe that temporary relief will continue to permit the private pension system to expand as rapidly as it must in the future. Would like to see S. 901 modified to include a solution to problem of four-forty vesting as well as the lifting of the freeze on the establishment of new salary reduction plans. Also would like Congress to take certain steps to simplify the hour of service rules.

Pension Rights Center, Karen W. Ferguson, Director (May 25)

Pension Simplification Act

Agrees that there are serious problems in the administration of ERISA but does not think that the divided jurisdiction approach in S. 901 is the solution which best serves the interests of pension plan participants and beneficiaries. Believes that the creation of an independent "Employee Benefit Protection Agency" is the only solution to the many administrative problems of ERISA. Indicates that such an agency would require legislative action but would meet all the objectives of the Executive Reorganization Act. Feels it could serve as the cornerstone for a National Retirement Income Agency which would consolidate all agencies, commissions, and departments dealing with retirement income, and possibly even encompass the retirement income aspects of social security sometime in the future. Contends that the proposed elimination of the "laundry list" of items required in section 103 of ERISA would be detrimental to employee rights.

Tax-Exempt Private Pension Investment Act of 1977

Suggests that the language in section 3 of S. 285 be amended to provide that a trust does not violate the fiduciary responsibility provisions "*solely because* an investment of such assets by a fiduciary of the trust is made in the securities of a corporation with a capital account of less than $25,000,000" etc. Believes that the provision should specifically state that the investment must be prudent in all other respects.

Prod, Inc., Arthur L. Fox, II, Counsel (May 25)

Pension Simplification Act

Supports S. 901 in principle but does not feel that the procedures outlined in the bill would best serve the interests of participants and beneficiaries. Asserts that the only sensible solution to overlapping jurisdiction is to assign full responsibility to a single agency or department, whether it be a new agency or an existing agency or department. Believes that section 103 of ERISA does a good bit to "keep the trustees and administrators of employee trust funds honest", but feels that the only way to insure that the disclosure requirements remain adequate to protect the interests of fund participants and beneficiaries is to continue to prescribe what those requirements shall be by statute rather than leaving the determination to the Department of Labor.

Does not favor the particular declaratory judgment procedures set forth in section 7 of the bill as the means for expediting government processing applications for exemptions of variances.

Tax-Exempt Private Investment Act of 1977

Strongly supports the goals and means of attaining them set forth in section 2 of S. 285. Agrees with all the reasons that have been recited in support of this provision to limit the degree of control of pension fund managers in large corporations. Questions whether pension fund managers should be restrained from dominating only those corporations valued at $150 million or more, as well as why the restrictions should apply only to those managers whose funds aggregate $1 billion or more. Suggests that these limits be reconsidered and lowered significantly. Also, supports the goals which section 3 is designed to promote but questions the wisdom of a blanket repeal of the ERISA fiduciary duty standard with regard to any portion of the assets of a pension fund.

Roy A. Schotland, Professor, Georgetown University Law School (June 28)

Pension Simplification Act

Supports the Pension Simplification Act. Feels that S. 901 would carefully and wisely improve the jurisdictional overlap in the administration of ERISA. States that the tax aspects of pensions make total severance from IRS unfeasible and that a similar situation exists with the Department of Labor.

Tax-Exempt Private Pension Investment Act of 1977

Supports S. 285. Feels that modification of the prudent man rule is clearly an important need and that the only sure and swift solution is to amend Federal law to make clear that mere size or newness or quietness of trading do not, in themselves, render an investment imprudent. States that S. 285 would reduce the risks in conflicts, protect the independence of portfolio companies, and increase equity for smaller stockholders. Feels that ERISA's diversification provision is unfulfilled until S. 285 passes. Comments that the largest pension fund managers should be treated just as we have long treated mutual funds and insurance companies which is to impose a ceiling on the holdings in any one stock.

Harrison V. Smith, Executive Vice President, Morgan Guaranty Trust Company of New York (June 28)

Pension Simplification Act

Supports the efforts through S. 901 to remedy deficiencies in the workings of ERISA. Believes that the Department of Labor should be charged with all responsibility for interpreting, administering, and enforcing ERISA—including fiduciary responsibility and prohibited transactions—with the exception of those matters that are strictly questions of Federal tax law which should be left with IRS. Contends that the prohibited transaction sections of ERISA should also be replaced with a rule that judges the validity of transactions between fiduciary and party-in-interest on the basis of adequate consideration.

Tax-Exempt Private Pension Investment Act of 1977

Does not support S. 285. Believes that it is based on important misconceptions as to the nature of the pension investment business.

Feels that S. 285 would be counterproductive and interfere with the capital allocation process by making markets less efficient and being detrimental to those companies seeking to raise capital and investors seeking to invest.

Committee of Publicly Owned Companies, C. V. Wood, Jr., Chairman (June 28)

Pension Simplification Act

Supports S. 901 since it addresses the "incredible complexity and confusion of the jurisdictional and reporting requirements of ERISA."

Tax-Exempt Private Pension Investment Act of 1977

Considers S. 285 to be a measure of the greatest urgency and of fundamental importance. Suggests that the "prudent man" rule be amended so as to provide explicitly that determination of the prudence of the investment judgment of fiduciaries should be based upon the total portfolio rather than upon the quality of each individual investment. Believes the stated objective of ERISA should be amended to declare as the national policy that tax-exempt funds should be invested in a diverse selection of American companies. Recommends that section 3 of S. 285 be amended to broaden the category to which it relates by increasing the maximum capital account of companies to which it relates from $25 million to $50 million, and by removing the two-percent limitation.

Maurice F. Krug, Chairman and President of Technology Incorporated (June 28)

Tax-Exempt Private Pension Investment Act of 1977

Believes that the modification of the prudent man rule in section 3 of S. 285 should be changed to reduce the $25 million capital account ceiling to $5 million with no percentage limitation (or at least an amount higher than two percent) on the amount of pension assets which may be invested in these companies.

Computer and Communications Industry Association, A. G. W. Biddle, President (June 28)

Tax-Exempt Private Pension Investment Act of 1977

Endorses S. 285. Contends that ERISA's prudent man rule has discouraged pension fund managers from placing pension investments in other than large blue-chip and fixed-income securities. Unless Congressional intent is clarified he feels investments will not be made in small companies or in venture capital situations. Believes S. 285 will redirect the flow of investments funds to provide some degree of investment in medium- and small-size companies which otherwise would not take place.

Indicates that section 2, in requiring a five-percent limit with respect to any class of corporate security which meets the statute, puts pressure on the portfolio manager to distribute a fund's assets over a greater number of investments. Believes this process will result in enhanced portfolio yields for the pension funds to provide increased benefits to pensioners and beneficiaries.

John E. Jones, President, Cummins-Allison Corporation (June 28)

Tax-Exempt Private Pension Investment Act of 1977

Supports the underlying objectives of S. 285 "both because of the equity plight of my company and . . . the need for pension reform . . ." Feels that section 2 strikes at the heart of the unavailability of capital in small- and medium-sized businesses. Believes it would force pension fund managers to break from the few select securities enjoying a surplus of capital. Would like to see a much larger percentage of trust funds come within section 3 investments. Furthermore, believes more companies ought to benefit from the leeway provision in section 3 than just companies with capital assets of less than $25 million.

American Bankers Association, Charles Moran (May 25)

Pension Simplification Act

Contends that ERISA has caused a web of conflicting, duplicative and unnecessary administrative procedures established by the agencies with jurisdiction over employee benefit plans. Expresses concern that the disincentives created by these provisions may prove to be so great that the continued growth of benefit plan coverage may be jeopardized; and further that employers who already have plans will be deterred from increasing benefits. Views several provisions of ERISA as creating major problems—first, a litany of prohibited transactions; second, a broad definition of "party in interest;" and third, shared responsibility by the Department of Labor and IRS. States that the dual jurisdiction mandated by ERISA is inherently unworkable and has been recognized by most people who were involved in the original legislation as a necessary compromise, not a workable one. Supports efforts to alleviate the problems caused by this jurisdictional arrangement.

Asserts that the current exemption procedure has created a monumental logjam which prevents the orderly operation of the law. Recommends that the fiduciary responsibility provisions of ERISA including prohibited transactions be made the responsibility of one agency. The Association believes that the Labor Department is a logical location in which to place this responsibility. The ABA, however, does not believe it is necessary to substitute civil penalties assessed by the Secretary of Labor for the existing excise tax in the case of violations of prohibited transactions. Feels that the provisions of section 4 of S. 901, amending section 103 of ERISA, may be helpful in that it should result in the elimination of some unnecessary disclosures. Indicates concern, however, in view of the delays experienced under current law, over the language which again directs the Labor Department and IRS to act jointly.

Believes the contents and filing date of the annual report should be completely in the jurisdiction of one agency which would be directed to consult with the other, but the one agency's decision should be binding and the other agency should be prohibited from seeking such data. Feels that the Labor Department is a logical choice for determining the content of the annual report and the filing date. Urges the substitution of the duty of undivided loyalty and the sole benefit test of section 404 for the strict party-in-interest prohibitions. Considers the definition of fiduciary to be overly broad and needs alteration.

Tax-Exempt Private Pension Investment Act of 1977

Believes that S. 285 would unnecessarily interfere with the free marketplace and allocate capital through arbitrary investment restrictions, and that its enactment could well have a diametrically opposite effect in some ways from the one intended. States that even though the bill only imposes the five-percent limitation on those banks managing over $1 billion in pension assets, trusts departments of all sizes have expressed their opposition to the provision.

The Association also opposes the two-percent leeway provision. Feels that this "further erosion of the prudent man rule is not necessary because of the flexibility of the rule itself." Recognizes that many investment managers have misconstrued the prudent man rule of ERISA and have become more conservative. Indicates that it might be helpful if Congress were able in some way to restate its intent. Believes, however, that the language of the rule as contained in ERISA should not be changed since it was developed very carefully and really states well what the law should be. The Association's concern over the two-percent provision regards not only to the potential abuse which could be made of it but also to the standard which might be inferred from it.

Harold E. Bigler, Jr., Vice-President, Connecticut General Life Insurance Company (July 18)

ERISA Small Business Paperwork Reduction and Investment Act

Comments that section 11 of S. 1745 "can do no harm and might, in time, do some good." Does not believe that it will encourage the flow of pension funds into high equity investments in the present environment. Outlines various reasons for lack of funds available for venture capital and small business investments. Suggests various ways that such needed investment capital could be generated. Feeds that until reasonable and more historic rates of return have actually been experienced in traditional equity portfolios, there will be little capital flowing into high-risk investments. Opposes to specific guidelines for the allocation of funds—particularly venture funds. Believes that venture capital should be an equity-holder's risk and that economic stability is necessary to set a proper environment for risk taking.

Robert J. Hickey, Attorney, Washington, D.C. (July 18)

Supports S. 285 and S. 1745 but states that the desired result will not materialize unless the bills offer an "absolute no-risk protection" for fiduciaries making investments in small companies. Points out that investments in small firms that do not produce a high return face a greater chance of being challenged as imprudent than do investments in blue chip securities that produce a low or negative return, and that investments in small businesses are not worth the risk of litigation involved for the fiduciary making the investments in view of personal liability (sec. 409), suit by any beneficiary (sec. 502(a), and award of attorney's fees (sec. 502(g). Made several suggestions including development of clear guidelines of what would constitute a prudent small business investment, to aid judges in interpreting the law, provision for the award of attorney's fees against the plaintiffs, and placement of the burden of proof on the plaintiff. Feels that these steps would not eliminate litigation but would discourage suits and assure a speedy disposition of suits when they are brought.

Peter H. Vermilye, Chairman, Alliance Capital Management Corp. (July 18)

Endorses section 11 of S. 1745 that the size of a business alone would not disqualify such an investment under the prudent man standard. States that he would like to see spelled out in legislation that a plan's investments should be judged by the overall prudence and success and not by a single investment. Believes that a pattern of imprudence should have to be established to create liability, not a single unsuccessful investment. Opposes providing a two-percent leeway under S. 285, indicating that a specified percentage to be invested in smaller companies would not be desirable because pension funds have different objectives and characteristics. Comments that a set percentage might lead to the slighting of the prudence standards other than size that must apply to all investments. Suggests that the legislation should make clear that the standards of prudence still apply to smaller investments—through investigation, sound businesses, able management, etc.

John G. Mutschler, President, John Mutschler & Associates (July 18)

Feels that investments in small companies should not be *per se* a violation of the prudent man rule. Argues legislation should provide guidelines assuring that such investments, in the absence of negligence, will not be held imprudent. Believes that small plan terminations and the lack of new plans established by small employers are the result of the existence of individual retirement accounts (IRAs) and the prohibition by ERISA of transactions with the retirement fund that benefit both the plan and the employer.

Suggests that the law provide for limited employee retirement accounts (LERAs) so that employees could supplement employer contributions with their own savings and insure the continuation of plans. Points out that prior to ERISA, a factor with many small employers was that the funds could help the company grow while at the same time provide benefits to employees, e.g., the purchase or leasing of real and personal property or accounts receivable. Notes that this was permitted prior to ERISA by section 503(c) of the Code in the presence of an "arms-length" transaction, adequate security and an adequate rate of return. States that ERISA makes these "prohibited transactions," and permits them only after a specific exemption on the part of both labor and IRS. Feels that legislation should permit these practices if adequate safeguards are provided so that small companies again will be encouraged to establish plans.

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