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THE PENSION GAMBLE: WHO WINS? WHO LOSES?

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FRIDAY, JUNE 14, 1985

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The committee convened, pursuant to notice, at 9:38 a.m., in room SD-106, Dirksen Senate Office Building, Hon. John Heinz (chairman) presiding.

Present: Senators Heinz, Chiles, Pressler, and Warner.

Staff present: Stephen R. McConnell, staff director (majority); Larry Atkins, deputy staff director; Robin Kropf, chief clerk; Jane Jeter, minority professional staff member; Kimberly Kasberg, hearing clerk; Lucy Savidge, legislative correspondent; Sara White, assistant press secretary; Dan Tuite, printing assistant; Paul Steitz, majority professional staff member.

OPENING STATEMENT BY SENATOR JOHN HEINZ, CHAIRMAN

Chairman HEINZ. The Special Committee on Aging will come to order.

Next week, 35,000 working Americans will retire and collect their reward for a lifetime of work. And after the handshake and the office farewell, and maybe a small party, the question is what is their reward going to be.

Almost all will start receiving monthly Social Security checks in July, some for as little as $200, others for as much as $900—enough maybe to pay their bills through the end of the third week in July—and then, what?

For a fourth of these retirees, the reward will include pensions of $400 or more. Another fourth receive a smaller reward, a pension of a few hundred dollars a month.

Those are the lucky ones. Half of those retiring next week will receive no retirement benefits other than Social Security. They will join the ranks of three out of four elderly without pensions. It is not that they did not try to prepare for retirement, but pensions are a gamble, and they played by the rules, and they lost.

I suppose if those people could start all over again, you might ask, could they do better; what does it take today to earn an adequate pension? The first thing they have to do is get into a pension plan. This is the tricky part. The odds are only 50-50 that the job they find will have a pension and that they will be included in the plan. They should not be fooled, though. When they finally land a job with a plan, they have not made it yet. Part of the gamble in earning benefits is achieving the ever-elusive status of vesting, or becoming entitled to benefits. In most plans, this takes 10 years. If the workers are loyal or do not get better jobs, and their employers do not lay them off or fire them, they will eventually earn the right to receive retirement benefits.

For those who have earned benefits, the gamble is not over. Some may leave the company after vesting, either leaving behind their small benefits or cashing out and spending them. Employers may reduce or eliminate pensions in the end if Social Security provides most of what the employer has set as a retirement goal.

At the end of this pension obstacle course, there are the rewards. For some retirees, they will be substantial; for many, they will not. Those who will do the best are those who ran the course with the fewest obstacles—they found a good job with a generous employer and stayed there for a full career. Those who will finish the course with nothing are those who had the highest hurdles and the most false starts.

How can we rely in this country on a pension system that leaves so much to chance and that stacks the odds against particular career patterns and types of employment? Can the system, structured the way it is today, keep pace with the changes going on now in the work force and deliver the benefits this Nation will need in the future?

Unless we plan to indefinitely continue our heavy and increasing reliance on the Social Security System, we must find ways to encourage a broader delivery of greater pension benefits to future generations of retirees.

Coincidentally, as we discuss this issue, the Congress is beginning a comprehensive review of the fairness of the Federal tax system which provides an estimated $44 billion a year in tax benefits to private pension plans and participants—$44 billion in tax benefits. Can the distribution of pension tax benefits, big as they are, be viewed as fair when some workers receive much more adequate retirement income from pensions than others—and among those others are maybe half of all workers who receive nothing at all?

We are privileged today to have three panels of witnesses with expert knowledge of the problems and the potential of the pension system. The members of our first panel know firsthand how pension plans can keep workers from earning benefits. Their experiences, I think, may open the committee's eyes to the problems with pensions.

The second panel is here to explain the factors that keep workers from earning pensions and to give us a sense of what the future holds.

The third panel will help us understand the changes that companies and unions operating pension plans are dealing with and how plans could improve the delivery of benefits.

Chairman HEINZ. Our first panel today consists of Ronald Sprague, of Evendale, OH; Madeline "S", of Astoria, NY; Lola Falls, of Vancouver, WA, and Margery Boley, of Columbus, OH.

We welcome all four of you here. Some of you have come really quite long distances, and we are thankful for your willingness to participate.

I would like to start with Mrs. Boley, of Columbus, OH. Mrs. Boley, could you be our lead-off witness?

STATEMENT OF MARGERY BOLEY, COLUMBUS, OH

Mrs. BOLEY. Mr. Chairman, members of the committee, my name is Margery Boley. This is my first trip to Washington, DC, and I am so glad that I could come for such a good cause.

I came today to tell my story because I think it is very unfair that after working 20 years with a major department store, they would take away my pension and leave me with only Social Security.

After my husband died, I moved to Columbus, OH, to be near my daughter. In 1961, I got a job with J.C. Penney. I took the job working in the stock room because that was the only job available with a 40-hour workweek. I told them that I needed to work 40 hours because that was the only way I could make ends meet under the wages that I was paid.

I was glad to have the job, and throughout my years with the company, I did all kinds of jobs. After working in the stock room, I became a seamstress and worked in alterations in the men's department, the ladies', and the bridal shop. I received many compliments and commendations for a job well-done there.

After I retired from there, many of my customers that I had served while working there called me and asked me if I would do their work at my home, rather than having it done in the store. I say that only to say that I think I did a good job for them.

Later, I worked in the sales department, where on different occasions, I won awards for having the highest sales in my department.

It seems the more I did for the company, the less they did for me. First, they told me I would be cut back from 40 hours to 37½. This was done primarily so that no one would get overtime pay.

J.C. Penney had a habit of anyone that they gave a little raise to, they cut their hours back, and the last time I worked for them, I was cut back to 20 hours after being hired at 40.

They cut the hours back, but made it look like we were getting something when we got a raise, but indeed, we may have ended up with nothing more—maybe less—then what we had before.

When I got ready to retire in 1981 at age 65, I was getting $3.88 an hour. At that time, they hired another woman with no experience whatsoever in alterations, to replace me at $4 an hour. Even though I was training her on my job, she was hired in at more than I got in the 20 years that I worked for the company. When the personnel manager came down to ask me how the woman was doing, I told him she would probably do fine after I trained her on the job, because she had no training when she came in. I then asked the personnel man if he thought that was really fair that, after someone that had worked for 20 years was working for less than someone he hired in with no experience. The personnel man walked out of the room, slamming the door in my face, not answering my question.

The manager of the store heard about this and made the personnel man come down and apologize for acting that way, and they did me a big favor—they gave me a raise to $4.25, which I received for part of 1 week, the last week I worked for the company.

After 20 years, I hoped that at least I would get some sort of a retirement pension, but instead, I got a letter which said that I would not get a dime. What it said was that if the Social Security benefit meets the pension plan's retirement income goals, then no benefit is payable from the plan. Since Social Security meets the plan goals, there is no pension payable to me.

I really did not understand what this meant. A friend of mine explained that the plan used Social Security to wipe out the pensions of lower paid workers like me. This may meet the plan's retirement income goals, but it certainly does not meet mine.

What is so strange about all this is that I received statements from the company each year, telling me that I was fully vested. I guess I was vested in zero.

I should mention that I have heard that J.C. Penney changed the pension plan after I retired so someone like me would not completely lose out. Under the new plan, someone in my position would get a few dollars a month. But the question is, Why should a company be able to take away any of a person's pension by subtracting Social Security?

This is completely unfair. I always thought that the reason a company had a pension plan was to make sure workers can get more than Social Security at retirement. After years of work with the company, they certainly owe us something.

I hope Congress will act to put an end to this practice so that people will not be hurt in the future, as I was.

Chairman HEINZ. Mrs. Boley, that is just a classic story. It is a tragic story. Unfortunately, it is not a unique story. There are thousands of people who have discovered, at the end of 20 or even more years of absolutely faithful work, hard work, good work, that they have not received any pension at all. I do not say that to make you feel any better, although I wish I could make you feel better; I say it because I think it is a sign of the deep problems that we have with the way our pension system is allowed to operate.

It cannot be right to work for 20 years and be told that you have nothing coming to you from the company to which you have given your all, as I believe, from what I know of you, you did.

But I will have some more questions for you in a minute. I am going to ask each of you to testify first, and then I am going to come back and ask you and each of the others some questions.

Thank you very much, though, for that testimony. It really makes me mad to hear what has happened to you. Maybe it will wake up the Congress.

I would like Mrs. Lola Falls to be our next witness.

STATEMENT OF LOLA FALLS, VANCOUVER, WA

Mrs. FALLS. Mr. Chairman, members of the committee, my name is Lola Falls. I am here today from Vancouver, WA, to tell what happened when I was terminated from my job with the Freightliner Corp. after 9 years and 6 months. Because I was laid off before working 10 years, I did not earn the right to receive a pension at retirement. Now, all I have to look forward to at age 65 is a small Social Security check.

I always worked outside the home to help my husband support our son and my five stepchildren. Starting in 1961, I held several jobs working at companies in the Portland and the Vancouver area. When my husband died in 1967, my stepchildren were grown and out on their own, but I was faced with the responsibility of providing for myself and our youngest son, all alone. I never dreamed that I would have to spend my old age without my husband or plan for retirement myself.

In July 1972, I began work with Freightliner Corp. as a senior secretary in the parts division. Freightliner Corp. is a major manufacturing company in Portland; they manufacture heavy-duty, class 7 and 8 trucks.

I always enjoyed working there, and the management treated us well. I received regular raises, and felt as if my contribution to the company was appreciated. With my job going so well, I looked forward to being at Freightliner long enough to earn a pension.

Then in 1978, when Freightliner began marketing its own trucks, they started letting people go. There was a feeling of unrest among the employees, and my coworkers and I began getting worried.

During the next few years, I watched my performance reviews drop from a "superior" rating down to "satisfactory"—not because I worked any less efficiently or was less productive.

I kept my job until January 1982 when, at the age of 59, I was laid off along with 150 other employees. A great many of these employees were 40 years of age and over with a great many years of seniority with the company. The criterion was if you were 55 or over, with a full 10 years of service, you were actually retired and pensioned off. But if you did not have 10 years, you did not get anything. And of course, I was in that category, because I was 6 months short.

I mentioned to my boss, "Well, that hurts me particularly because I only have 6 months to go to vest in my pension plan."

And he just smirked and said, "Oh, well, there is one employee that only has 6 days to go."

So they selected these people very well.

If I had been able to work just another 6 months, I would have been eligible to receive a pension at retirement. Of course, the amount that I would have been entitled to was small, but any amount is significant, compared to nothing.

In addition to losing my pension, I also lost the medical and hospital insurance which was a part of the retirement package.

Since then I have done all I can to make ends meet. I have worked mostly for temporary agencies as a secretary. It was a long time before I worked again after being laid off, because of the recession. And as you know, the Northwest part of the country still is not fully recovered from the economic slump. But fortunately, the periods when I don't work now are much shorter.

Although I have looked for a permanent job, I have not had much luck. I just get excuses, like, "You are overqualified for this job," or "You wouldn't be satisfied with what we would be able to pay you." That is just a good disguise for age discrimination.

I am still applying for openings when they come up, but now I am careful not to tell my age or give my salary history.

It really hurts after working all my life that I will not get a pension from any of these companies. I thought for sure that at least I would have gotten something from Freightliner Corp., but even that fell through.

I do hope that this committee would look into changing the law to help people in my position. I think a law should be passed to shorten the time required to vest in a pension plan.

I do thank you for the opportunity to come and speak to you today.

Chairman HEINZ. Thank you very much, Mrs. Falls.

It is my hope that the Congress, this committee, the committee of jurisdiction on which I also serve, the Finance Committee, will enact legislation which addresses a number of issues. One of them needs to be the fact that there are a group of people, women in particular, some of your age, some younger, who have limited attachment to the work force—who may be contributing to a pension plan and their employers are telling them that they are contributing on their behalf to a pension plan, who lose their pensions either because of a change in management of the company, or because the company simply goes out of business.

At the same time, people are, fortunately, always becoming better-educated; people are becoming more able workers, and we have a more mobile work force. Thank goodness for that. But it seems that one of the prices we pay for that mobility, or for the tremendous ups and downs in employment, is that people who should have something coming to them when they reach retirement age, and who have worked for many years, end up, for no good reason, with nothing. As I said in my opening statement, we have a $44 billion tax expenditure here, and the public has a right to be asking—and that is the question we are really asking here—what valuable social role are we achieving with that $44 billion tax expenditure.

And so far, what I have heard from you and Mrs. Boley is—not much, not much.

Let me ask our next witness, Madeline "S" to please proceed.

STATEMENT OF MADELINE S., ASTORIA, NY

Mrs. S. Chairman, members of the committee, my name is Madeline S., and I am pleased to have come from Astoria, NY to tell my story. I hope that what I have to say will do some good in getting pensions for other people, even though it might be too late for me.

Let me start off by saying that I have decided not to use my full name or the company's name, because I am afraid of losing my job. I have been told that the pension law is supposed to protect people in my position, but that it is not very effective. If I were to lose my job now, at age 58, I know I would be hard-pressed to find another one. And, knowing I am not getting a pension, I need to work as long as I can.

I started working for my present employer, a bank in New York, 23 years ago. I was 35 years old. I was hired at that time at 25 hours a week as a file clerk, and I was told that because I was part time, I would not be entitled to a pension or any other benefits. But honestly, at that time, with two children at home—they were 12 and 14 years old—and my husband's job was always on rather shakey ground, I did not care much about the benefits. I needed the money.

As it turns out, a few years later, my husband's company, Hooven Letters, Inc., went out of business, and with it went my husband's 27 years of service and his pension; he got nothing.

Now I am nearing retirement age, and we are both afraid that there will be little income for us to account for in our final years. Because my husband had to start all over again at the age of 47, he is going to get a very small pension himself. Ironically, I got him a job at my bank—he started as a messenger boy, after a previous career as a manager—and now he will be the one getting the pension, small as it may be.

I have to tell you I feel so cheated by the company. I see other employees with far fewer years than I have, retiring with benefits just because they worked a few more hours a week than I did.

Why does the law give employers the right to decide who deserves to be included in the pension plan? Considering that I worked for a company longer than almost anyone else, and I was always there to fill in for other positions when I was needed, I feel I should have been in the plan, too. I cannot tell you how many times I would work full-time hours when I was asked, filling in for those people on vacation, or perhaps when they had a busy period, but then I would be told after another time that I must soon return to my part-time hours; otherwise, complications would arise, and I would have to be eligible for benefits.

This shows how arbitrary the policy is. In my case, working "too many hours" would make that I work on an hourly, not a salaried, basis. The pension plan says that anybody working on a hourly basis—and that means all the part-timers—can be excluded. But this does not really make any sense to me. Doesn't ERISA say that employees who work 20 hours a week, or 1,000 hours a year, which I do, should be included in the plan? I was told that my employer took advantage of certain exceptions to the rule that allows him to exclude all the part-timers as a class.

Now, let me ask you, why should employers be getting big tax breaks to set up plans if they are allowed to leave out whole categories of employees?

In my case, they have excluded employees on an hourly basis even if they do meet the 1,000-hour rule. I even heard of another woman who was excluded because she was a secretary, and the only woman in the firm. I think this is very unfair.

Pension plans to me are supposed to give people retirement income based on their wages. Why should some employees be covered by pension plans while others are not? As long as this law allows employers to exclude employees, they will certainly do so. My bank has a pattern of hiring part-timers—mostly women—to save money.

I certainly hope Congress takes a serious look at this problem and changes the law so that employers can no longer arbitrarily exclude employees from pension plans.

Thank you very much.

Chairman HEINZ. Mrs. S., first of all, I want to thank you for doing a difficult thing, which is to come down and testify—and there is a risk, even though you have not told us whom you work for, or what your name is. I really appreciate that.

We do not often realize the kinds of sacrifices people who help the Congress take. Every so often, you are reminded, as we were by a story on the front page of the Washington Post today, where the Pentagon whistle-blower was determined to have been punished by his boss for having told Congress what was going on, and he was transferred from the east coast to California. It reminded me that although they caught the people who did this, that there are a lot of very unhappy, unfair tactics that are used against employees.

I thank you on behalf of the committee. What you have said reflects quite accurately a loophole that exists in the pension law. What you have described also is to me an abuse that we need to do something about.

I am going to have some more questions for you, as I will for our other witnesses, but I thank you very much.

Mr. Sprague, welcome. Please proceed.

STATEMENT OF RONALD L. SPRAGUE, EVENDALE, OH

Mr. SPRAGUE. Mr. Chairman and members of the committee, I am Ronald Sprague, a registered professional engineer in six States, and a member of the Institute of Electrical and Electronic Engineers. I have been a practicing engineer for 22 years, have worked for seven employers, and currently have no retirement savings, other than what my wife and I have contributed toward individual retirement accounts.

My career has been a characteristically mobile engineering career, and thus has deprived me of opportunities to benefit from pension accruals that would have been possible had I stayed with one employer for these 22 years. In addition, my wife has suffered from my mobility, and although a working spouse, has accrued no vested pension benefits other than through an IRA.

I received my BSEE degree in 1963 and soon afterward, was employed by the city of Los Angeles. From 1963 until 1967, I worked for the department of water and power as an engineering assistant. When I left this employment after approximately 4 years, in 1967, I had no vested benefits in the pension plan, other than my own after-tax contributions to the plan. I left employment with the city of Los Angeles and removed my own contributions.

In 1967, I accepted employment with the General Electric Co. at Cape Canaveral, FL. During my tenure with GE, I was employed with several different locations, performing engineering work related to the Apollo Space Program and other programs. Sites that I was at included Cape Canaveral, FL; Daytona Beach, FL; and Castle Hayne, NC.

During this period of employment, I survived two major layoffs and eventually resigned from General Electric, after having been transferred to the North Carolina location. Upon my resignation in 1972, after approximately 5 years, I received only my own after-tax contributions to the retirement plan.

From 1972 until 1978, I founded a construction company and my own consulting business, neither of which provided a retirement program for the employees. It was my judgment that I was not in a financial position to be able to provide a Keogh plan for all of my employees, and therefore, I was not able to offer any employer-sponsored retirement program.

In 1978, I terminated my consulting business and accepted employment with EG&G, Inc., in Idaho Falls, ID. EG&G was a service contractor providing support services to the U.S. Department of Energy. It was this benefit period that has provided me with the only accrual of retirement benefits provided by the employer. Having worked for EG&G from 1978 to 1984, I remained with the company longer than the required vesting requirement of 5 years and thus was able to withdraw my own contributions, plus those company contributions for which I qualified.

In 1984, I resigned from EG&G and received cash-out employer contributions of approximately $1,500, in addition to my own contributions. Unfortunately, these moneys were needed to finance a move to Florida, where I had accepted a new employment offer.

From June 1984 until January this year, I worked for HLM Engineers in Orlando, FL. Even though my tenure for HLM was very short, a more lengthy stay would not have provided any pension accruals, as there was no company-sponsored pension plan offered.

In January of this year, I commenced employment with KZF, Inc., in Cincinnati, OH. They offer no company-sponsored pension plan.

As I noted at the beginning of my testimony, I have pursued a mobile career in engineering, having an average time per employer of approximately 5 years, not including the self-employment periods or my current employer. Unfortunately, the price my wife and I have paid for my mobility is a forfeiture of opportunities to accrue substantive retirement benefits by remaining with an employer who provided a company-sponsored pension plan.

In fact, during this period of my employment career, my wife has also had eight different employers in her nursing career, none of whom offered her a pension plan. Even if she had been able to participate, it is unlikely that she would have been able to vest because of my mobility.

During this career, perhaps I have been a little more fortunate than many other mobile individuals, in that I have had at least one employer that had an uncharacteristically short vesting period associated with its pension plan. I should point out, however, Mr. Chairman, that this 5-year vesting period precisely coincided with the length of the contract of EG&G with the Department of Energy. I started work with EG&G 2 years into the original contract and vested only because the contract was renewed.

In summary, my wife and I have had a collective total of 15 employers since my engineering career began. We currently have only our IRA investments to depend upon for retirement income

I would like to express my appreciation, Mr. Chairman, for the opportunity afforded me today to appear before your committee and share my experiences with you. I hope that my testimony will assist you and the Congress to develop needed pension reform legislation that would assist a mobile employee to accrue much-needed pension and retirement benefits.

Additionally, Mr. Chairman, I would like to request that you include in the hearing record the testimony of my professional society, the IEEE, and that of three other technical/professional societies, the American Institute of Chemists, the American Society of Civil Engineers, and the American Society of Mechanical Engineers,[1] who are concerned for their own members and the general public as they suffer from the mobility of their professions.

Chairman HEINZ. Without objection, the testimony of each of those groups will be included in the record, and we are delighted to have that.

Mr. SPRAGUE. Thank you.

Chairman HEINZ. Does that conclude your statement, Mr. Sprague?

Mr. SPRAGUE. Yes, it does.

Chairman HEINZ. I want to thank you. Your situation is quite different from that of your three cowitnesses, but illustrates an equally significant point. You appear to be a very bright, able, successful engineer who has been climbing up that ladder of success that we say is so much a part of America. And what, apparently, you are finding is that unless you stay on each rung of the ladder with some rare exceptions, a lot longer than the manufacturer of those dreams ever told you is necessary, when you get to the top rung and look down, you realize that you have come a long way, but you do not have much in the way of a pension benefit to show for it.

Before I turn to questioning, I want to recognize my two colleagues who came in during the course of the testimony—Senator Lawton Chiles, whom I have had the pleasure to serve with on this committee for so many years, and who is one of the staunchest advocates for the elderly. Senator Chiles, how is the budget conference doing today? You do not have to answer that question.

STATEMENT BY SENATOR LAWTON CHILES

Senator CHILES. We are making progress slowly, Mr. Chairman. I want to congratulate you on holding these hearings. I think this is a subject matter that certainly concerns everybody in our country, and is of great concern to people who are nearing elderly, or know that they are going to be there, because of their concern as to whether they will have the wherewithal and so that they will be able to put that together. Certainly, it has been a frustrating subject to us in the Congress. Many times, what we thought we were doing did not turn out to be just that way, and now we are seeing some of the results of where people are cutting the melon of these pension funds and making vast profits, even affecting what mergers are taking place.

I think there is no more timely subject that we could be involved with, and I congratulate you on holding the hearings and I find them of great interest.

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[1] See Appendix, p. 71.

I am delighted to have this panel of witnesses. Anyone who has the ability to work in Florida, that is about as close as heaven can be, but there should be the ability to get a pension from that, as well.

Chairman HEINZ. Senator Chiles, thank you.

I am also pleased to introduce Senator Pressler of South Dakota, who has probably been the most active member of this committee. I have been privileged to have him take the initiative on hearings. I have come out to South Dakota to see the problems of the rural elderly with him on one occasion.

Senator Pressler.

STATEMENT BY SENATOR LARRY PRESSLER

Senator PRESSLER. Well, thank you very much, Mr. Chairman, and I want to thank you and Senator Chiles and the witnesses and the staff for holding this hearing because I think it addresses a very great problem, and I hope to join with you in potential legislation.

I am particularly interested, and I do apologize, in Madeline S.'s part-time worker's testimony, because just last week in South Dakota, I had a lady who had worked part time for many years and found herself without any pension benefits. This lady had actually worked as much as a full-time employee, but it was classified as part time.

I want to join in legislation and I think this is a very important subject. During one of my SS listening meetings, I heard a case exactly as the first case listed on this first panel, and I am going to read the testimony very closely. I think with the growing use of finding ways to classify employees as part time even though they work over 1,000 hours a year is a problem. On the other hand, the employers have a problem if somebody is truly part time. But there has sprung up a practice, I believe, in some areas and in some types of work, of finding ways to classify people as part-time employees, and they end up without any security. So I thank the chairman and I look forward to working on legislation with him as a result of these important hearings.

Chairman HEINZ. Senator Pressler, thank you very much, and I welcome the opportunity to work with you on the legislation. I think it will be possible to develop good legislation that will address many, and maybe even all, of the problems we have heard and will hear about today, and I thank you very much.

[The prepared statements of Senators Glenn and Denton follow:]

STATEMENT OF SENATOR JOHN GLENN

Mr. Chairman, I am pleased that the U.S. Senate Special Committee on Aging is holding this hearing on "The Pension Gamble: Who Wins? Who Loses?" We have heard much discussion in recent years, particularly during the Social Security refinancing debate, about the need to plan for a financially secure old age through private pension income and savings to supplement Social Security benefits.

It has been pointed out that more people retiring today receive pension benefits than in the past. This is the good news. However, the questions before us now are: Will this trend continue? Will private pension income reach lower-income workers in the future? Or, as the trend of shorter job tenure and increased mobility accelerates, will pension income reach today's relatively well-paid mobile workers in their retirement years?

Today, three-fourths of retired Americans, aged 65 and older, receive no retirement benefits beyond Social Security. This figure is startling when one considers the rapid expansion of pension coverage during the 1940's and 1950's. The picture is somewhat brighter if looked at in terms of households. Almost half receive some pension income—although it is less than $400 monthly for half of these families. Therefore, while it is true that more older Americans receive pension benefits today than they did in the past, it is important to remember that they still receive relatively little retirement income from private pensions.

We are hearing a great deal about tax reform these days. The Federal Government has encouraged employers to provide pensions by its tax policies. Employers deduct their contributions, and the contributions and income earned by the pension trusts are tax-free for many years, until received by employees as a benefit. The major tax "loss" is the tax-free accumulation of trust earnings. The Congressional Joint Committee on Taxation has estimated Federal tax expenditures for employer-provided plans—based on contributions and trust earnings—at $55.1 billion for fiscal 1986, $61.7 billion for fiscal 1987, $69.1 billion for fiscal 1988, $77.4 billion for fiscal 1989, and $86.7 billion for fiscal 1990. This totals $350.1 billion over 5 years.

Clearly, if we are going to "pay out" this kind of tax expenditure, we must ensure that we have a fair and workable pension system in return. In recent years, Congress has sought to expand coverage and benefits by changes in the tax code as well as changes in Federal law governing and regulating private pensions. These modifications are essential. The imperfections of the current system skew pension and tax benefits away from uncovered employees, mobile workers, and low-wage earners toward the pension-covered employee with moderate to high earnings, who stays with the same job for many years. Today's hearing will examine these important issues, and I look forward to reviewing the testimony presented by our able witnesses.

Statement of Senator Jeremiah Denton

Mr. Chairman, you and the staff of the Special Committee on Aging are again to be congratulated for your efforts in planning and preparing a hearing of vital concern to all Americans.

I believe that many Americans will be surprised to learn that nearly half of America's private employees are not covered by an employer-sponsored pension plan. I was shocked to learn that three-fourths of those 65 and older receive no pension benefits. Currently, Social Security appears to be filling the gaps, but most people acknowledge that, from any perspective, sole reliance upon the Social Security system is unwise. Social Security benefits simply do not provide sufficient income replacement for retired workers.

Mr. Chairman, I hope that this hearing will alert workers of all ages to their need for coverage under an employer pension plan, or for a personal savings substitute, and to the risks of losing benefits when they change jobs. It also appears that we in Congress need to do serious thinking about the inter-relationship between Social Security and private pension plans. We evidently need to learn more about the way in which employers are choosing to integrate pension and Social Security benefits to achieve income replacement goals for their retirees.

In short, Mr. Chairman, I know that I shall benefit from the hearing record and I hope that the Congress as a whole will pay careful attention to the effects of various tax proposals on the pension system. I hope that we can find cost-effective ways of encouraging the creation of pension plans by small and mid-sized companies that currently find it difficult to offer workers a pension program.

As the baby boom generation grows older, it is obvious that both the government and the private sector must work together to ensure true income security for an ever larger proportion of our citizens. As with any form of savings, pensions and pension policy demand foresight on the part of employers, employees, and government policy makers.

This hearing represents just that kind of foresight, Mr. Chairman, I commend you for it. Thank you.

Chairman Heinz. I have some questions for some of our witnesses. I guess the thing that I would really like to establish—I think we, from your testimony, understand what the unfairness of the situation is. I think we also ought to get on the record really what that unfairness amounts to, if you can ever measure it, in almost dollars and cents.

Let me ask Mrs. Boley, though, to amplify her situation. When was it that you first discovered in your 20 years with J.C. Penney that you would receive no pension benefit? How long had you been there?

Mrs. BOLEY. I was there from July 17, 1961, to June 1, 1981. One of my records says June 1, one says May 31.

Chairman HEINZ. Well, did you not discover your lack of benefits until you retired?

Mrs. BOLEY. I did not know. Every statement that I got from the company said you are fully vested. When I received my notice when I retired, they said that my Social Security was sufficient to reach their goal, so they did not give me any, said I could not receive any pension whatsoever.

Chairman HEINZ. So there you were, and literally, the week you were retiring, you found out that you really were going to get no benefits.

What kind of benefit had you been counting on, thinking you were going to get at that point, before you found out the bad news?

Mrs. BOLEY. Well, I did not know the exact amount, but I certainly expected a pension of some kind—something.

Chairman HEINZ. Some kind of pension.

Mrs. BOLEY. At least something.

Chairman HEINZ. You did not know if it was going to be $50 a month, $250 a month, but you thought it would be something.

Mrs. BOLEY. Yes, I did.

Chairman HEINZ. Did you make contributions to any pension plan?

Mrs. BOLEY. At that time, we did not make contributions.

Chairman HEINZ. Did the company say it was making contributions in your behalf?

Mrs. BOLEY. That is the way I understood it.

Chairman HEINZ. You are getting no pension, so I imagine whatever you get is—what—Social Security?

Mrs. BOLEY. That is correct.

Chairman HEINZ. What is your monthly retirement income now?

Mrs. BOLEY. Three hundred and forty-six dollars after cost-of-living raises.

Chairman HEINZ. Three hundred forty-six dollars a month, after 20 years of work. That is all Social Security.

Mrs. Falls, when you were working at Freightliner, what kind of income did you expect to receive when you retired?

Mrs. FALLS. They sent us an annual statement, and the last one that I got said that combined with my Social Security and my pension, I would receive something over $900 a month.

Chairman HEINZ. What do you think your Social Security benefits are going to be now?

Mrs. FALLS. Approximately $500.

Chairman HEINZ. Five hundred. What is going to happen to you, of course, is that you are not going to get the difference between that $500 and $900, are you?

Mrs. FALLS. Oh, that is correct.

Chairman HEINZ. That is called nearly a 50-percent cut.

Mrs. FALLS. Very close.

Chairman HEINZ. Nearly a 50-percent cut in your retirement income and your expectations.

Mrs. FALLS. Right.

Chairman HEINZ. You mentioned that there was another person who was laid off 6 days before—you were laid off 6 months before you vested in the plan. Were there other people besides that person and you who also were close to vesting at Freightliner who were laid off?

Mrs. FALLS. I do not know how close some of them were, but of this 150 that were laid off at the same time I was, there were somewhere between 30 and 40 percent of those people who were over 40 years old, were in this age category. Those who had over 10 years of service, of course, did get their pensions.

Chairman HEINZ. To be within 6 months, and indeed to sacrifice $400 a month, and to miss that by 6 months, is to have the work of a great deal of time, effort, commitment snatched away from you at the last minute.

Mrs. FALLS. Right.

Chairman HEINZ. Mrs. S., did many of your coworkers at the bank have similar part-time hours, and were those employees also, like you, excluded from their retirement plan?

Mrs. S. Oh, yes.

Chairman HEINZ. What kind of workers at the bank were included in the plan—only salaried people?

Mrs. S. People that had full-time hours, whether they were maintenance people, the tellers—everyone—except those that were paid on an hourly basis, which is what I came under, the hourly basis—they were excluded.

Chairman HEINZ. The law reads if you work more than 1,000 hours—and you did——

Mrs. S. Oh, yes.

Chairman HEINZ [continuing]. Per year, that you should be in a pension plan, but there is a waiver provision that says that that can be ignored, I guess it's the proper word for it, if you are in a class of employees that is excluded from the plan, but that is not discriminatory based on your earnings that dropping you out of the plan somehow does not discriminate on the basis of earnings against you.

Don't ask me who wrote that. Don't ask me why they wrote that. But I cannot explain it. I can hardly even say it. But that is apparently what caught you.

When you retire in another 5 or 10 years, what do you and your husband expect to have for income?

Mrs. S. We have no idea. We think about that all the time. With rents the way they are—we live in an apartment; we could never get a home, because our income would not allow it—and the rents are tremendous in New York, as everyplace else. We just go to sleep at night and say, well, when the time comes, we are going to worry about it, because what is the sense of worrying about it now? I do not know, really, what we are going to do.

Chairman HEINZ. Will you have Social Security, do you think?

Mrs. S. Yes. I do not know how much it will be, but I am sure it is not going to be very much. And my husband is 62 years old, and he is going to get a very meager—because he is only in the bank 11 years. They say it is "cigarette money," actually.

Chairman HEINZ. So he will have a very low——

Mrs. S. Very low. I have nothing, and he has that. So, how we are going to do this, I really do not know. I do not really want to think about it.

Chairman HEINZ. Neither of you will have any other pension benefit.

Mrs. S. No.

Chairman HEINZ. You will have something from Social Security. You do not know what that is going to be.

Mrs. S. No, no idea.

Chairman HEINZ. Beyond that, you just do not know.

Mrs. S. No idea what we are going to do. And he has worked—well, he is 62—he started at 20, at 17. He has worked all his life, and he has very little, as I said.

Chairman HEINZ. Let me ask Mr. Sprague, and then yield to Senator Pressler, when you first started, Mr. Sprague, what were your career goals as an engineer? What did you want to do? What did you want to be? How did you see your career developing?

Mr. SPRAGUE. Well, when I first started—that is an interesting question—I had no clearcut goals.

Chairman HEINZ. In a general sense, though, how did you look at the next 5, 10, 15 years? What kind of ideas did you have about what you wanted to do? Was it to just be a good engineer; was it to, as you eventually did, have your own firm? What did you really——

Mr. SPRAGUE. When I first started, I had no goal other than to be a reasonably good engineer. And as I matured, I began to look more and more at starting a firm, which I have done, and going into supervisory roles, going into management roles, being in responsible charge.

Chairman HEINZ. At what point after working as an engineer, I guess, all your employment career to date, did it ever occur to you that a pension benefit might be something worth thinking about?

Mr. SPRAGUE. I would say about 10 years ago, about half my career.

Chairman HEINZ. When you were about 36?

Mr. SPRAGUE. Yes.

Chairman HEINZ. When did you begin to become really concerned that you had earned no pension benefit?

Mr. SPRAGUE. About that same period in time.

Chairman HEINZ. You mentioned at one point, you cashed out of a pension benefit; is that right?

Mr. SPRAGUE. Yes.

Chairman HEINZ. Could you have paid for the move to Florida without using the pension benefit if you had had to, for the job that you were seeking?

Mr. SPRAGUE. It would have created a much larger strain than not having cashed out.

Chairman HEINZ. What do you plan to do for the next 20 years that might allow you to earn a pension benefit?

Mr. SPRAGUE. I feel that I have a good 20 years of productive employment left—possibly more.

Chairman HEINZ. I consider 46 youthful in the extreme.

Mr. SPRAGUE. Yes; it is amazing how one's perspective changes. I plan on addressing that issue head-on as soon as I finish financing some college work for some daughters. That will be the next goal, to accrue assets for a retirement fund.

Chairman HEINZ. What you have all told us is that there is just enormous uncertainty out there, and most people do not know it until it is too late, or almost too late.

The only person of the four of you who has a chance at this point is Mr. Sprague, and it may or may not work out for him.

My time is expired.

Senator Pressler.

Senator PRESSLER. Well, I want to say that we could perhaps have a fifth witness from the U.S. Senate staff because I think, until a year ago—our staffs could opt not to pay into the retirement program. I know of cases in Washington of people in their sixties who have worked part-time or full-time for the U.S. Senate as an employee and have no pension or Social Security, because they chose to pay into the retirement system and were not required to pay into Social Security. We have passed some legislation that has corrected this problem. Until 1 year or 2 ago, a Federal employee could opt whether or not to participate in the Federal retirement program if they were a congressional staffer. Part-time employees would not qualify for benefits and employees could draw out their retirement plans upon departing from the Federal Government. Now, those are decisions that they made, and were hopefully their own decisions. The point is, I believe we could find people in their sixties who have done a lot of work up here on the Hill, on congressional staffs. Congress passed a new law which took effect in January 1984 which required employees to take Social Security.

Chairman HEINZ. Everybody is now under Social Security.

Senator PRESSLER. Including us?

Chairman HEINZ. Including us—at long last.

Senator PRESSLER. Yes.

Chairman HEINZ. After legislating everybody else's Social Security benefit since 1935, we finally decided that if it was good enough for everybody else, maybe it would be a good idea for us to have a little personal experience with it.

Senator PRESSLER. But am I not correct that until that time, an employee could——

Chairman HEINZ. Up until that time, participation in the Federal Employee Benefits Program here on Capitol Hill was voluntary participation, and if people did not participate, they could end up with absolutely nothing.

Senator PRESSLER. Now, I would like to pursue the part-time issue with Madeline S. You worked over 1,000 hours a year. I thought if you worked over 1,000 hours a year, you would be classified as a full-time employee.

Mrs. S. That is what I thought, too. May I say that I have a neighbor who started all this because she worked for an insurance company. She worked the same hours I did. And in conversation, she came up with the fact that she was entitled to a pension. And that is what made me decide, well, how come she is, and I am not.

So I questioned the personnel, and I was told something to the effect that it was an option that they could have taken, but they did not—something very vague—and they just said no, that is not so; you are not entitled to it, and that was it. I just accepted that.

She worked for some other company. My company, this particular bank, does not go along with this 1,000 hours. You have to work 35 hours a week. And I was working 25 hours a week.

Senator PRESSLER. All right. Now, it says ERISA also permits an employer to define a class of individuals and exclude them, as long as the effect is not to discriminate in favor of the highly paid.

Could staff or somebody explain to me, then, if someone worked over 1,000 hours, how would they be classified as part-time? I thought ERISA said 1,000 hours is the break-off.

Chairman HEINZ. The Chair would state that the law is that you are by law treated as full-time, therefore includable in a pension plan, employee, if you work more than 1,000 hours. However—however—the catch 22 is if you are in a certain class such as being hourly paid—in this instance, being hourly paid was the class—the company may elect to exclude you from participation in the pension plan if it can be demonstrated that the people in that class are no worse off financially than people in some other class, that is, people working 35 hours or more, who are on salary and are not on part-time.

Now, the kind of catch 22 No. 2 that came in here is that the company basically had a rule that said you cannot be on salary unless you work at least 35 hours, and as I understood what Madeline S. said, she was on—did you say that you were on salary at one point, and then when you got over a certain number of hours, you became an hourly person?

Mrs. S. No. I was always hourly.

Chairman HEINZ. You were always hourly.

Mrs. S. But what I did say was there were times during my employment that they would ask me to fill in full-time, many times, 2 or 3 weeks for those people on vacation, and I would get a salary, still on an hourly basis—still—and then, when a certain time would elapse, they would come to me and tell me, "Go back to your part-time hours, because it is going to run into complications; you will go over the time, and you are going to have to be entitled to benefits." So immediately, they would send me back—and I never understood that, either. But that is the policy.

May I say also, I asked for a copy of the pension plan, and all it said was those people that are excluded from the pension are, No. 1, those people who are paid on an hourly basis, and No. 2, those people who are hired over 60 years of age. Those are the only two people, and I came into that.

Senator PRESSLER. I see. So, in other words, you fall into a category—and of course, let me say that I am not just here to blame the companies, but we are trying to dig out the facts—but it appears to me it would be almost impossible for an individual to know the laws well enough to insist on requiring fair treatment, or they are not in a position to insist. Also, let me say that there may be an analogous problem—not to be picking on the Government—but I am told there is an analogous problem in some cases where a State worker switches over and works for the Federal Government, in some instances there can be a windfall if you get a State pension and also a Federal pension. But there are some individuals, let us say they work for a State or a unit of government long enough before it vests, and maybe we should have—and maybe we do have—I know there are some plans that tie in with the Federal retirement program. We cannot run a give-away program, but on the other hand, there are some Federal employees who have been municipal employees or State employees who fall into the same category by virtue of a series of events, usually, unbeknownst to them. And maybe this is an area where we could offer more of a plan to municipal or State governments.

But it appears to me—and it has crossed by mind that a lot of these part-time classifications are deliberate circumventions of getting around participating in employee benefit programs. I think we should try to address the part-time problem legislatively, we may be able to address the hourly issue, and not discriminate in favor of the highly-paid. It sounds to me as though that is the thing that invites a company to skirt the intent of the law. That is something we will have to review.

But let me also say I think that these hearings are useful to educate people; individuals also have a responsibility to find out as much as they can. Could you have found this out, and what would you have done—of course, you probably would have been fired if you had raised the issue.

Mrs. S. Are you saying did I not know this?

Senator PRESSLER. Yes. Why didn't you assert your rights, whatever they might have been, why didn't you go in and say, "Hey, look, this isn't fair"?

Mrs. S. I did not want to create any disruption. I need my job. And they do not have to let me go because of that, but they would find other reasons, that maybe my job was not needed anymore. I was just afraid. I do not think I could go out and—after 23 years, where am I going to go?

I did not want to create any waves.

Senator PRESSLER. That is right. It was impossible for you to go in and assert your rights, because you might not have had any—you might have had some, but the average person does not have a lawyer as their guardian angel.

Mrs. S. Right, exactly.

Senator PRESSLER. Well, I thank you very much.

Mrs. S. Thank you.

Chairman HEINZ. I have just one last question, I guess, for Madeline S.

Were there many other people like you, or are there many other people like you, at your place of employment—that is to say, part-time people?

Mrs. S. Yes.

Chairman HEINZ. There are a lot of part-time people?

Mrs. S. Yes; well, they would rather have the part-timers, because they do not get any hospital benefits or pensions or anything.

Chairman HEINZ. What proportion of the work force would be part-time people?

Mrs. S. At the present time, maybe one-quarter.

Chairman HEINZ. Maybe a quarter; a very substantial number.

To answer Senator Pressler's question as to how this really works, what you really do is you take a group of very low-paid employees, who maybe are in the same category as Mrs. Boley, who have been working at near-minimum-wage jobs. Perhaps there is an integration feature in the pension plan where, when they retire, because of the way the plan is structured, the Social Security is subtracted from the plan retirement benefit, and the company pays zero. But for the here and now, because of the mathematical calculation that is allowed, low-paid employees are in a pension plan, high-paid employees, maybe management, is in the pension plan, and people in the middle are allowed to fall through a loophole and crash right down on the concrete at age 62 or 65. That is how that works. It doesn't seem right, does it?

Mrs. S. No.

Chairman HEINZ. Now, what you have all in sum described is that there are obstacles, there are hurdles—and you do not even know they are there. Nobody even tells you, as you run down this employment path, that there may be a pit right at the end of it into which fall, and you have no way of knowing frequently, and that is certainly the case in several of the stances here.

I think you have been an extraordinarily articulate and helpful panel of witnesses. Is there anything any of you would like to add? Yes.

Mrs. FALLS. One category of employees that we have not addressed is temporary employees. They work 40 hours a week, but they actually are employees of the agency. And you are working for the agency's client, so of course, you are not eligible for benefits that way. But the large companies are going more and more to temporary employees. I am working on a job now that is that way, and I find that there is a large percentage of people there who actually are temporary employees. They do not actually work for the company. And every year, there gets to be more temporary employees.

Chairman HEINZ. That is really an extension of the problem that Madeline S. was talking about, but you are quite right; for employers to hire temporaries from some firm that specializes in doing that——

Mrs. FALLS. They skirt all of the benefits that way. They are just bypassed.

Chairman HEINZ. That is right. We are going to address that problem, too.

Anything else?

[No response.]

Chairman HEINZ. Thank you all very much. We deeply appreciate your testimony, very, very much.

We have another panel of witnesses, Dallas Salisbury, the president of the Employee Benefit Research Institute, and Judy Schub, legislative representative for the American Association of Retired Persons.

The Chair would like to note the presence of a former member of the Aging Committee staff, Frank McCardle. Frank, we hope that you are in a position to vest in your new responsibilities. I do not think the portability of Senate pensions at the time you decided to move on was of the greatest. It is nice to see you. And I would note that Dallas Salisbury is fortunate to have you assist him down at the Employee Benefit Research Institute. You were an outstanding member of the staff of this committee, and I think we can probably get a majority vote on that in your favor—especially today.

Well, Dallas, do you want to be our lead-off, please, on this topic?

STATEMENT OF DALLAS SALISBURY, WASHINGTON, DC, PRESIDENT, EMPLOYEE BENEFIT RESEARCH INSTITUTE

Mr. SALISBURY. I would note, Mr. Chairman, that the institute's 401(k) plan has full and immediate vesting, and our money purchase pension plan has 4-year vesting, with 25 percent vesting beginning in the first year.

Chairman HEINZ. A physician that has healed himself, or herself.

Mr. SALISBURY. So Frank should be able to—he is definitely already moving along the vesting track.

I want to commend you, Mr. Chairman, for having held this hearing on a most important subject, and I would ask, in order to stay brief, that my full statement be included in the record of the hearing.

Chairman HEINZ. Without objection, so ordered.

Mr. SALISBURY. The importance of the subject was recently noted in an April 1985 Hamilton and Associates survey. Fifty-eight percent of the employees polled indicated that they viewed their pension as one of the most important aspects of their employment, and in terms of concerns over the long-term viability of Social Security, 82 percent agreed with the statement that if employers did not provide benefits, the Government would end up paying directly.

This makes it particularly important that Congress work to encourage a strong private employer pension system and a public employer pension system. To date, congressional actions have shown results. In 1950, only 25,000 pension plans existed in this country; today, over 800,000. In 1950, only $13 billion in accumulated assets were there. Today, private employer plans have over $925 billion, with an additional $300 billion in public employer plans.

On the benefit delivery side, the system is doing better, as you noted. In 1950, essentially no retirees had employer pension income. In 1962, benefit receipt had grown to approximately 10 percent of retirees. By 1985, pension programs sponsored by employers will pay aggregate benefits of over $90 billion to retirees, with 25 percent, as you noted, of all elderly—but more importantly, with 56-percent of newly retired married couples getting pension income, and with 42 percent of newly retired unmarried persons getting pension income—something that over time will raise the averages on pension receipt by all retirees, if you will.

I direct your attention first to black and white chart number one in my testimony.[1] Fifty-two million workers today are covered by pensions; as that chart 1 indicates, over 83 percent, or approximately 10 million, public employees today have pension coverage. Over 50 percent of all private sector workers are covered, or approximately 40 million employees, representing 70 percent of full-

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[1] See p. 32.

time, full-year workers. In both sectors, there is still room for improvement.

You noted that the employer-sponsored pension system, is helped to be paid for by a $45 billion annual reduction in Federal revenues. The application to chart 1 is that approximately $20 billion of that expense is attributable to public employee plans; approximately $25 billion of that expense, to private employer plans.

As you note from that chart as well, coverage has dropped. We have attributed that drop to three particular reasons. One, a tremendous shift in employment during the most recent recession from manufacturing to service industries. Manufacturing employers traditionally have had pensions; many service industries do not. Second, the continuing drop in unionization; and third, the growth of small business.

I direct your attention to chart 2 [2] to indicate why those last two trends are so important. Twenty-three percent of employees with firms of only 100 employees, are covered by a pension plan. By the time one moves to the largest firms, as chart 2 indicates, pension coverage rises to over 82 percent of employees.

Unionization is another very important factor. Only 44 percent of those in nonunionized jobs are covered by a pension, whereas in unionized settings, over 82 percent are covered.

So these factors do explain a tremendous amount about who is and who is not covered. And, for the employee at a young age who chooses to plan to get a pension, this information at least provides some guidance to aid them in moving into the "pension" gamble.

Who isn't covered? For that purpose, I direct your attention to chart 3 [3]; 15.4 percent of noncovered workers are self-employed. Approximately 3 percent are in agriculture. Nearly 25 percent of all noncovered workers in 1983 were under 25 years of age. The Retirement Equity Act brought into the system last year this group of 9.5 million workers; it allowed to participate approximately 500,000 young workers, or increased participation by 1 percent—not a huge increase, but a real increase.

Workers age 65 or older are a special case under the law and represent 2.7 percent of the noncovered. Workers without coverage who were on the job less than 1 year account for 9.7 percent, and those who worked less than 1,000 hours, but who otherwise would have had the plan, represented 10.3 percent.

Those workers meeting all 1983 participation standards except that their employers did not sponsor a plan made up 34 percent of the noncovered work force. Principally they have ended up being those working for very small businesses and those working in nonunionized settings.

To help understand where the gaps are, nearly 82 percent of all noncovered employees worked for employers with less than 500 employees; 68 percent worked for firms with less than 100 employees; 89 percent are in nonunionized jobs—I repeat, 89 percent of the noncovered are heavily influenced by the nonunionization trend in our society, and 44 percent are under age 35. As noted by the last

[2] See p. 33.
[3] See p. 34.

panel, many people do not tend to start worrying about retirement until the age of 36.

What are some of the specific issues that you raised in your opening statement that one might try to deal with in addressing this problem?

Vesting, as you well know, represents having a nonforfeitable right to a benefit. Nearly 58 percent of all those now covered by an employer-sponsored plan have a vested right to a benefit. Reduction to a 5-year vesting standard, as some have suggested, would vest approximately 1.9 million additional workers, increasing the vested rate to 62 percent.

One caveat, which was noted by the last panel, as well—under current law, there is the ability for an individual to accept a lump sum distribution at early ages and to spend it. Also under the law, there is the ability of a company, for any benefit amount of less than $3,500, to cash out the benefit.

I therefore stress another provision of what you are talking about—that individual choice option. Faster vesting will only result in additional retirement income, if you include a requirement that the money must be saved for retirement. If, on the other hand, you do not include the requirement that it be saved for retirement, it will simply serve to increase severance payments. That does not mean faster vesting is not a good thing, but I attempt to stress that it is very much tied with the other changes that you are discussing.

Portability is another issue, and there, to be brief, I will only note that portability again runs into this issue of individual choice and the lump-sum distribution. Portability can be of tremendous value if the money or the credits that are transferred must be retained until retirement age, rather than simply increasing consumption over the working career. If public policy goes without that and allows this money to be consumed at any age, retirement income will not be increased, even though individual equity might be. If one goes to the question of whether or not the pension system is delivering for some, as both your fancier color graphics, and my more private sector, cheaply financed, nonprofit institution, black-and-white, graphics——

Chairman HEINZ. I understand you could not get your equipment to work. [Laughter.]

Mr. SALISBURY [continuing]. Indicate, the pension system that the Congress has helped to encourage is providing for a large number of people. There is definitively room for improvement. The improvements need to come from a comprehensive set of integrated actions. I would only stress the importance of the committee continuing down the track that it has so well begun, with the excellent work of prior staff as well as current staff, to try and make certain that changes that stand alone but do not increase retirement income are not made without simultaneously making changes that will assure that such things as portability and vesting do actually increase retirement income delivery.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Salisbury follows:]

PREPARED STATEMENT OF DALLAS SALISBURY

Mr. Chairman, I would like to begin by commending you and the other members of this Committee for scheduling this hearing on a subject of special importance to today's workers and retirees. The Employee Benefit Research Institute is a nonprofit, nonpartisan research organization based in Washington, DC. EBRI does not make recommendations for or against legislation the Congress may be considering, but we are pleased to make available to you and the Committee all the pertinent facts that may bear on your decisions.

In an April 1985 survey conducted by Hamilton and Staff, 58 percent of full-time workers rated the existence of a pension plan at work as being "very important." Only 15 percent of those polled felt that Social Security would be a major source of retirement income. Sixty-four percent believed they would have enough money in retirement, though most of these apparently believed that employer-sponsored pensions would enable them to achieve that goal. When asked if they would have enough to retire with a reduced pension, only 24 percent answered "yes." A full 82 percent of employees agreed with the statement that: "If employers did not provide benefits, the government would end up paying." The answers to these survey questions reflect the importance of employer-sponsored pensions to the American worker—and why this Committee is concerned about them.

The system of employer-sponsored pensions is becoming increasingly more important to the provision of retirement income nationwide. I choose the term "employer-sponsored" quite deliberately, because from a policy standpoint, the state and local government is an employer that provides benefits in much the same way as private-sector employers. Granted, the law with which you are concerned, the Employee Retirement Income Security Act, specifically does not cover anything but private-sector situations. But for virtually all of the issues about which you are concerned—coverage, vesting, portability, and adequacy of retirement income—the role of government employers should not, in my opinion, be left out of the analysis. This is particularly true since the tax treatment of these programs at the individual level is identical in both public and private settings.

The role of employers in providing pensions has increased dramatically, especially in the aftermath of World War II. Twenty-five thousand private employer-sponsored retirement income and capital accumulation programs existed in 1950 with accumulated assets of $12.7 billion. The participation rate for nonagricultural wage and salary workers was 25 percent.

Over 800,000 private employer-sponsored retirement and capital accumulation plans exist today with accumulated assets exceeding $925 billion. Were private pension plan assets to grow at the same rate as they have since 1968, which is highly questionable for a number of reasons, they would reach $7.5 trillion by the year 2000, according to some very rough estimates by EBRI. Today, there is an additional $300 billion in assets in state and local plans, which could grow to $2.7 trillion by the year 2000, again according to our very rough estimates. The coverage rate for private nonagricultural wage and salary workers is 50 percent (see Chart 1) and over 80 percent for public-sector employees.

In 1950, the percentage of retirees receiving pension income was negligible. By 1962, 16 percent of retired married couples and 5 percent of unmarried retirees received pension income. By 1982, a Census Bureau survey found 33 percent of over-age 65 married couples and 15 percent of unmarried retirees had private pension income. The Social Security Administration recently found that among new beneficiaries substantial numbers of retirees had pension income from an employer-sponsored plan: 56 percent of married couples had pension income—38 percent with private pension, 21 percent with public pension; and 42 percent of unmarried beneficiaries had pension income—27 percent with private pension and 16 percent with public pension.

For the "newly retired" couple in 1981, in cases where only the husband receives a benefit, the average Social Security check was $671 per month; those with pensions received an additional $656. When both the husband and the wife received benefits, the monthly Social Security check rose to $836 and the pension income rose to $899. The pension income was greater than the asset income, which added $539 per month.

As these statistics indicate, the retirement and capital accumulation plan system has grown significantly over the past 35 years in terms of participants, assets, benefit recipiency, and benefit amounts.

HOW IS THE SYSTEM CHANGING?

The absolute number of workers covered by pensions has continued to grow, but due to the large number of new jobs being created by small businesses, the percentage of the total work force covered by plans has declined. The primary reason: small business does not provide pension coverage at the high rate found in large businesses (see Chart 2). If this does not change, then pension coverage is nearly as high as it can ever be expected to climb. The United Kingdom, for example, has had 50 percent of the work force covered by employer pension plans for twenty years.

It is difficult to increase coverage and participation. Last year, for example, Congress enacted the Retirement Equity Act (REA), which reduced the age for participation from 25 to 21, and the age for counting service for vesting from 22 to 18. EBRI estimates that these changes increased participation by 530,000 workers—or about 1 percent—and increased vesting by 300,000—or about 1 percent. In short, only 5.6 percent of the 9.5 million workers between the ages of 21 and 25 worked for employers with plans and worked at least 1,000 hours per year and had been on the job for one year. The improvements from REA are real, but such minimum standard changes are no replacement for increases in coverage through new plan creation among small businesses.

WHO IS COVERED?

Forty-nine million of 88 million nonagricultural wage and salary workers were covered by employer-sponsored programs in May of 1983 (56 percent). Most covered workers earn relatively modest salaries. Over 76 percent of all covered employees and 70 percent of all vested employees earned less than $25,000 a year in 1983 (see Table 1).

When one considers those that ERISA required to be included in employer plans—i.e., those between the ages of 25 and 64 working 1,000 hours per year and on the job at least one year—the base drops to 54 million workers, of which 38 million (70 percent) are covered by a private or public employer-sponsored plan (see Table 2).

Who is covered by an employer-sponsored plan is not a gamble. Coverage is a function of very predictable factors: in large firms of more than 500 employees—82 percent of nonfarm private employees are covered; in unionized firms—82 percent of workers are covered; among those 45-64 years of age—65 percent are covered; and of workers in durable goods manufacturing, nearly 80 percent of the ERISA work force is covered, versus an unusually low 34 percent coverage of the ERISA work force in the business service sector.

Firm size and union status are clear predictors of whether an employer-sponsored pension plan will be available.

WHO ISN'T COVERED?

The statistics allow noncovered workers to be sorted into seven categories (see Chart 3). About 15.4 percent of noncovered workers own their own businesses. These self-employed workers appear to provide retirement protection for themselves through their investment in their business.

Three percent of noncovered workers are in agriculture. Their coverage rate is the lowest of all noncovered groups at just over 10 percent. Many agricultural employees are low-wage seasonal workers, employed on more than one farm. They frequently face a complex set of other labor market problems.

Nearly 25 percent of all noncovered workers in 1983 were under 25 years of age. This age group was not subject to ERISA participation standards according to the 1974 law. Young workers are more likely to have short years of service and to work part-time schedules.

Workers 65 years of age and older are also a special case; 2.7 percent of all noncovered workers fall into this group. ERISA states that defined benefit plans may exclude all new employees within five years of normal retirement age. Furthermore, benefit accruals have not been required beyond the normal retirement age (usually age 65), although employers do provide post-65 pension accruals.

Workers without coverage who were on the job less than a year account for 9.7 percent of the noncovered, and those who usually worked less than 1,000 hours a year accounted for another 10.3 percent of all noncovered workers. ERISA standards state that pension plans only need credit a year of service to employees who work 1,000 hours or more under the plan.

Those workers meeting all 1983 participation standards, except that their employers did not sponsor a plan, made up the remaining 34.4 percent of all noncovered workers. This last group represents 16 percent of total employment.

Nearly 82 percent of all noncovered employees work for employers with less than 500 employees; 68 percent work for firms with less than 100 employees. Eighty-nine percent are in nonunionized jobs; 44 percent are under 35; 51 percent have been on their current job less than five years (see Table 3).

To sum up, Mr. Chairman, under the participation standards laid down with much forethought in 1974, even if every employer in the country offered a June 11, 1985 pension plan, two-thirds of those not covered today would remain not covered.

VESTING

Vesting represents having a nonforfeitable right to a payment from the retirement or capital accumulation plan. This payment may be in the form of an annuity or lump-sum payment. If the accrued value is less than $3,500 upon separation from service, the worker can be required to take the lump sum.

Nearly 58 percent of all those covered by an employer-sponsored plan today have a vested benefit in the plan at their current employment. Reduction to a five-year vesting standard, EBRI estimates, would vest approximately 1.9 million additional workers, increasing the percentage of covered workers with vested benefits to 62 percent. Defined benefit plans, which currently have more than 40 million participants, now commonly use the ten-year "cliff" vesting standard allowed in ERISA. Defined contribution plans, with approximately 28 million participants, use many different schedules, with the average vesting period being six years. Most public employer pension plans use five-year vesting.

This vesting level in current employment plans is complemented by benefit entitlement—vested status—earned under plans from previous employment. About 6.6 million workers reported entitlement to a pension benefit from a previous employer's plan in May 1983.

The number of individuals with vested benefits from current and former employment will continue to grow as the system matures and the work force continues to age. As an increasing number of employers adopt supplemental defined contribution plans with shorter vesting schedules than the ERISA ten-year standard, an increasing number of workers will achieve vested status.

A reduction in the vesting minimum standard from ten years to five years would increase defined benefit plan costs by between 2 and 7 percent of payroll, were the employer to maintain the same benefit formula. EBRI estimates indicate that the result could be many more workers being eligible for small benefit amounts. Under current law, the workers could be required to accept these small benefit amounts as immediate lump-sum distributions upon separation from employment. Under these current rules, data indicate that these amounts are generally consumed, rather than used to increase retirement income (see Table 4). In other words, faster vesting will only increase retirement income if workers are required to roll over distributions into another retirement plan.

PORTABILITY

The President's Commission on Pension Policy identified several different forms of portability in a 1980 paper. First, there is the form guaranteed in ERISA, the ability of an individual to leave a plan and still have a right to receive a benefit when he or she reaches retirement age.

Second, there is a variation on a form we have today, the ability of the individual to take cash from the plan and place it in another retirement arrangement. Today, the individual can have a cash distribution under some circumstances, but when there is a cash distribution he or she is not required to place it in another retirement arrangement.

A third form of portability would allow the individual to carry "vested credits" to a new employer and in turn the old employer would transfer cash to the new plan. As a result of the breakup of AT&T, the regional telephone companies have had to try to make this system work, and they have a long, complex way to go. This form is very complex and can involve large administrative expenses.

A fourth form of portability would create a "central portability agency" that would receive cash or credit amounts for individuals and would maintain a benefit account for them as they vested in the plans of different employers over their careers. An effort to accomplish this with a super defined benefit plan formula would be very complex and expensive. Were this to be accomplished via a defined contribution type account, a rollover IRA could serve the same purpose without the need for a new portability organization.

The interest in portability primarily arises because when a worker leaves a defined benefit plan with a vested right, the amount of the benefit is "frozen." To the degree that the economy experiences inflation and the individual experiences income increases, that frozen benefit loses real value by the time the individual retirees. Therefore, the argument is made that the individual would be better off if he or she could cash out the benefit. In fact, many defined benefit plans already cash out benefits with a value of less than $3,500 to avoid the long-term administrative cost of "carrying" the records. Because these amounts are generally consumed, they represent a transformation of retirement income into a severence payment (see Table 4).

The key question for purposes of policy, therefore, is what happens to preretirement lump-sum distribution. If the primary objective of Congress in establishing these tax incentives is to encourage capital formation and savings, then what happens to lump-sum distributions at preretirement ages is primarily important to the test of short-term versus long-term capital formation, not retirement income. If, on the other hand, the primary objective of these tax incentives is to encourage annuitized retirement income, then what happens to lump-sum distributions is very relevant to retirement income. Only if preretirement age distributions are "captured" until retirement age, rather than immediately consumed, will they produce retirement income.

The language in ERISA indicates that Congress has had both objectives. That is, that Congress intends to provide tax incentives both for retirement income and for savings that will, under certain circumstances, be consumed prior to retirement. Yet, the success of both types of incentives is often judged against the percent of retirees receiving income during retirement from these programs. Further, given these dual objectives, the immediate consumption of lump-sum distributions is consistent with congressional intent, not part of any "gamble." In short, it is not a failure of the employer-sponsored retirement and capital accumulation plan system.

If Congress is unhappy with this outcome, then it behooves Congress to reconsider the objectives set forth in ERISA and to clarify for employers and employees why provisions of the tax law that have been in place since 1921 are no longer desirable national policy.

WHAT ISSUES WOULD PORTABILITY RAISE FOR ADEQUACY OF RETIREMENT INCOME

A number of questions arise in the consideration of portability. First, would mandatory portability increase or decrease actual retirement income. As noted, if "portability" is deferred as permitting cash outs which can be immediately spent, then it would decrease retirement income. If "portability" allows the individual to take cash out from a defined benefit plan and invest the funds, later realizing poor investment returns, the same may be true. On the other hand, higher investment returns would increase retirement income. But in that case you're betting that the average individual will be able to outperform the experienced money managers retained by pension plans.

Second, would portability discourage plan sponsorship? Probably not, if it simply took the form of requiring cash distributions. If, on the other hand, it involved creating a new portability agency to be financed by plan sponsors, it might discourage pension plans, particularly among small employers.

Third, would portability increase or decrease system costs? If employees simply paid cash or were required to roll over cash distributions to an existing financial intermediary, total system costs could remain relatively stable and simplification would be achieved. If a new agency were formed, as some have proposed, and employers have to transfer values in and out of defined benefit plans, experience indicates that cost and complexity would rise significantly.

BENEFIT DELIVERY

Congress must eventually decide what it is seeking to achieve with tax incentives and ERISA. Is the intent solely to provide retirement income, or is an equal objective savings and capital formation through deferral of income by employees for periods extending to the termination of covered employment or beyond? Program coverage may not be an important in both cases. The percentage of retirees with monthly pension income is only relevant to judging the retirement incentive, not the savings incentive, which can be served by distribution prior to retirement. Debates of the recent past have assumed that retirement income is to primary objective. Thus, the "Retirement Equity Act." Yet, with earlier participation, vesting, and a higher cash out limit, retirement, income might actually be reduced as cash preretirement distributions increase. For savings plans, is it equitable that an individual can quit and take the money, while an ongoing employee can't have access to the funds in an emergency? Does equity dictate that even in a savings plan all the money that goes in stays in until some common point in time? These are not simple questions, but they need to be answered before more changes in the law are made that further confuse objectives. As noted, over time, the Retirement Equity Act will lead to millions of additional small cash distributions that will be spent. Is that what Congress actually wanted to do, Is that "Retirement Equity?"

CONCLUSION

Congress has provided incentives for retirement and capital accumulation programs for over 60 years. The incentives have worked well in both areas. Congress should not overlook the long history of incentives for income deferral and begin judging all programs against a retirement income standard unless Congress makes it clear that is where the priority lies. That may be the best national policy, but it should be recognized as the clear shift in policy that it represents. And policy changes intended to create retirement income should be carefully tested to assure that they meet that objective.

A national policy that redefines itself to be a national retirement income policy, rather than a retirement and savings policy, would demand may changes in the rules. But, the first question is whether this fundamental change is merited and desired.

TABLE 1: EMPLOYMENT, COVERAGE AND VESTING: DISTRIBUTION BY EARNINGS FOR NONAGRICULTURAL WAGE AND SALARY WORKERS, MAY 1983

EARNINGS	Number of Workers (000's)		
	Employment	Coverage	Total Vested Benefits
Total	88,214	49,530	28,708
$1-4,999	10,014	2,433	358
$5,000-9,999	15,323	5,747	2,023
$10,000-14,999	17,827	10,328	5,484
$15,000-19,999	13,101	9,422	5,874
$20,000-24,999	10,283	8,159	5,641
$25,000-29,999	5,515	4,365	3,048
$30,000-50,000	6,611	5,547	4,071
$50,000 and over	1,615	1,371	1,106
Not reported	7,924	2,158	1,105
	Percentage Distribution Within Earnings Group		
	Employment	% Covered to Employed	% Vested to Employed
Total	100.00%	56.15%	32.52%
$1-4,999	100.00	24.29	3.57
$5,000-9,999	100.00	37.51	13.20
$10,000-14,999	100.00	57.93	30.76
$15,000-19,999	100.00	71.92	44.83
$20,000-24,999	100.00	79.34	54.85
$25,000-29,999	100.00	79.14	55.26
$30,000-50,000	100.00	83.91	61.57
$50,000 and over	100.00	84.90	68.50
Not reported	100.00	27.23	13.94
	Percentage Distribution Across Earnings Groups[a]		
	% Employ-ment	% of Coverage	% of Total Vesting
Total	100.00%	100.00%	100.00%
$1-4,999	12.47	5.14	1.30
$5,000-9,999	19.08	12.13	7.33
$10,000-14,999	22.20	21.80	19.87
$15,000-19,999	16.32	19.89	21.28
$20,000-24,999	12.81	17.22	20.43
$25,000-29,999	6.87	9.21	11.04
$30,000-50,000	8.23	11.71	14.75
$50,000 and over	2.01	2.89	4.01

SOURCE: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement.

[a] Percentages exclude 9.0% of employees whose earnings are not reported.

TABLE 2: EMPLOYMENT, COVERAGE AND FUTURE BENEFIT ENTITLEMENT BEFORE AND AFTER THE RECESSION, MAY 1983 AND MAY 1979

	Employment (000's and % of Employed)	Coverage (000's and % of Employed)	Future Benefit Entitlement (000's and % of Employed)
1983			
Civilian Employment (All employees & self-employed)	98,964 100.00%	51,530 52.07%	24,095 24.35%
Nonagricultural Wage and Salary Workers	88,214 100.00%	49,530 56.15%	22,217 25.19%
Nonagricultural Wage and Salary Workers age 25 to 64 only	68,252 100.00%	42,463 62.21%	20,934 30.67%
Nonagricultural Wage and Salary Workers age 25 to 64, working 1000 hours or more	61,586 100.00%	40,702 66.09%	20,476 33.25%
ERISA Work Force (age 25 to 64, working 1000 hours or more, one year of tenure or more)	54,363 100.00%	38,057 70.01%	20,027 36.84%
1979			
Civilian Employment (All employees & self-employed)	95,372 100.00%	53,445 56.04%	22,633 23.73%
Nonagricultural Wage and Salary Workers	85,181 100.00%	52,019 61.07%	21,399 25.12%
Nonagricultural Wage and Salary Workers age 25 to 64 only	63,201 100.00%	42,576 67.37%	19,836 31.39%
Nonagricultural Wage and Salary Workers age 25 to 64, working 1000 hours or more	58,009 100.00%	40,830 70.39%	19,522 33.65%
ERISA Work Force (age 25 to 64, working 1000 hours or more, one year of tenure or more)	49,736 100.00%	36,890 74.17%	18,941 38.08%

SOURCE: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement.

TABLE 3

THE DISTRIBUTION OF COVERED AND NONCOVERED WORKERS
IN THE "NEAR-ERISA" WORKFORCE
AGES 25 THROUGH 64 WORKING 1000 HOURS OR MORE
BY SELECTED CHARACTERISTICS, MAY 1983

	Covered Workers (000's)	Distribution Across Groups	Workers Not Covered[a] (000's)	Distribution Across Groups
FIRM SIZE[b]				
Less than 100 employees	6,215	17.4%	12,352	68.1%
100 to 499 employees	5,545	15.6	2,465	13.6
500 or more employees	23,869	67.0	3,314	18.3
Total	40,702	100.0	20,894	100.0
UNION STATUS				
Union	15,223	38.2	2,163	10.6
Nonunion	24,627	61.8	18,155	89.4
Total	40,702	100.0	20,894	100.0
EARNINGS[d]				
Less than $10,000	4,107	10.4	6,711	34.6
$10,000 to $24,999	24,545	62.1	10,374	53.5
$25,000 or more	10,866	27.5	2,309	11.9
Total	40,702	100.0	20,894	100.0
AGE				
Less than 35	14,588	35.8	9,095	43.5
35 and over	26,133	64.2	11,800	56.5
Total	40,702	100.0	20,894	100.0
HOURS				
Less than 2000	7,525	18.5	5,481	26.2
2000 and over	33,176	81.5	15,413	73.8
Total	40,702	100.0	20,894	100.0
SEX				
Women	16,335	40.1	9,932	47.5
Men	24,367	59.9	10,963	52.5
Total	40,702	100.0	20,894	100.0
TENURE[e]				
Less than 5 years	10,613	28.0	8,328	51.3
5 to 9 years	9,734	25.7	3,958	24.4
Ten years and over	17,518	46.3	3,830	23.6
Total	38,017	100.0	16,116	100.0

[a]Includes workers with no coverage, workers who do not know whether they have coverage and workers with no coverage information reported.

[b]Percentages exclude 12.7 percent of employees for whom firm size is not known.

[c]Includes workers who are not covered by a union contract, workers who do not know whether they are covered under a union contract, and workers with no reported information on unionization.

[d]Percentages exclude 4.4 percent of employees whose earnings are not reported.

[e]Total excludes 11.2 percent of employees who have worked at their current job for less than one year, doesn't include d/r.

SOURCE: Preliminary tabulations of EBRI/HHS May 1983 CPS pension supplement.

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TABLE 4

The Use of Preretirement Lump-Sum Distributions
by Purpose and Amount
(as Reported May 1983)

	Total	less than $5,000	$5,000 - $9,999	$10,000 - $19,999	Over $20,000
TOTAL RECIPIENTS[a] (000's)	6,594	5,533	583	218	154
Percent Distribution[a]	100.0%	84.2%	8.9%	3.3%	2.3%
ALL USES[b]	100.0%	100.0%	100.0%	100.0%	100.0%
Total Saving	32.0%	26.0%	57.6%	78.9%	87.3%
Retirement Program	4.4	2.4	*	*	*
Insurance Annuity	*	*	*	*	*
Housing Purchase	10.1	9.3	12.5	*	*
Other Investment	16.8	14.0	29.9	45.9	*
Total Consumption	71.4%	76.6%	51.9%	42.6%	*
Car Purchase	4.8	4.8	*	*	*
Vacation	3.2	3.1	*	*	*
Other Use	63.4	68.7	40.9	*	*

a Recipients by lump sum amount are less than total recipients and percentages are less than 100 percent because of the omission of "don't know" and "no response" to the survey question on the value of the lump-sum distribution.

b Percentages may add to over 100 percent because recipients may have used lump sum distribution in more than one way.

* Number of workers too small for rates to be calculated reliably.

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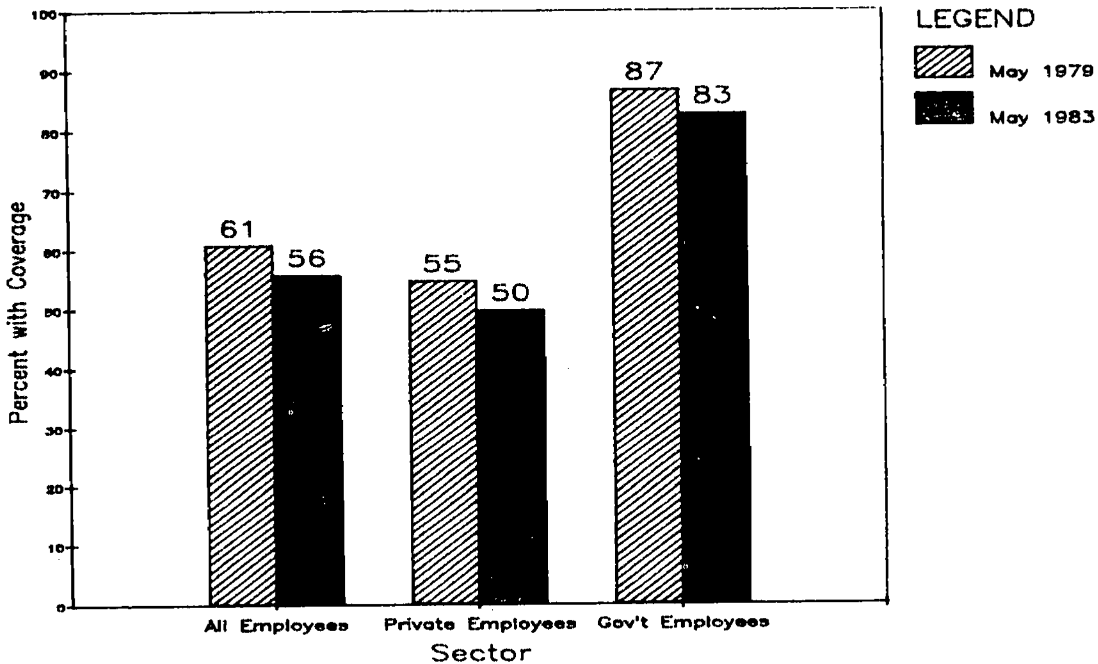
Chart 1

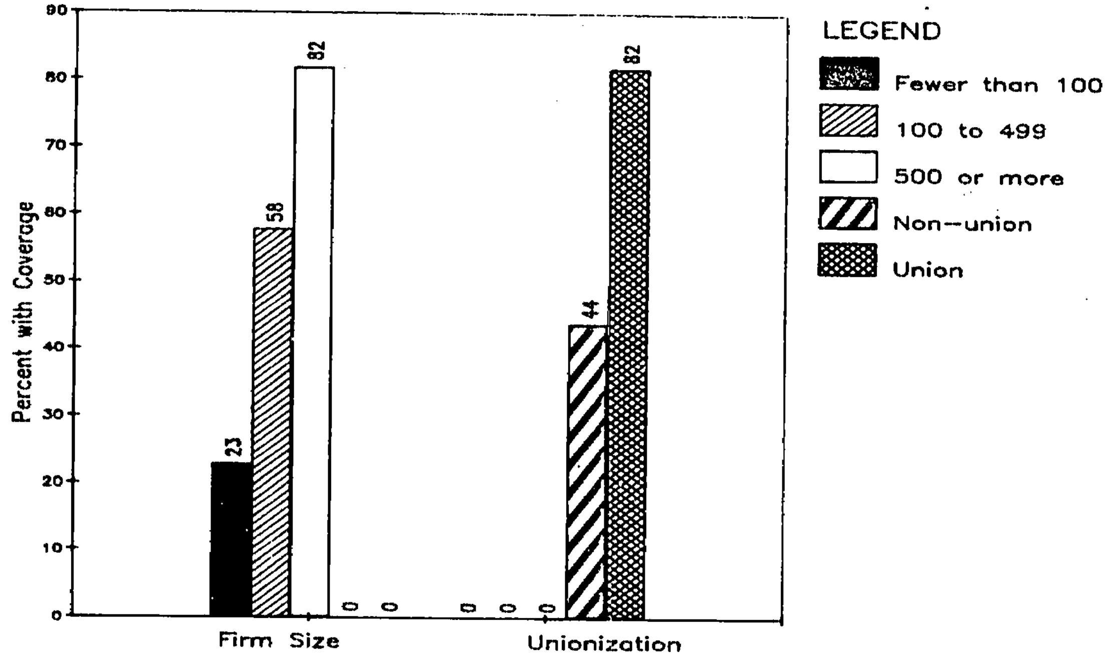
Percent of Non-Farm Workers with Pension Coverage, by Sector, May 1979 and May 1983



Source: Employee Benefit Research Institute

Chart 2

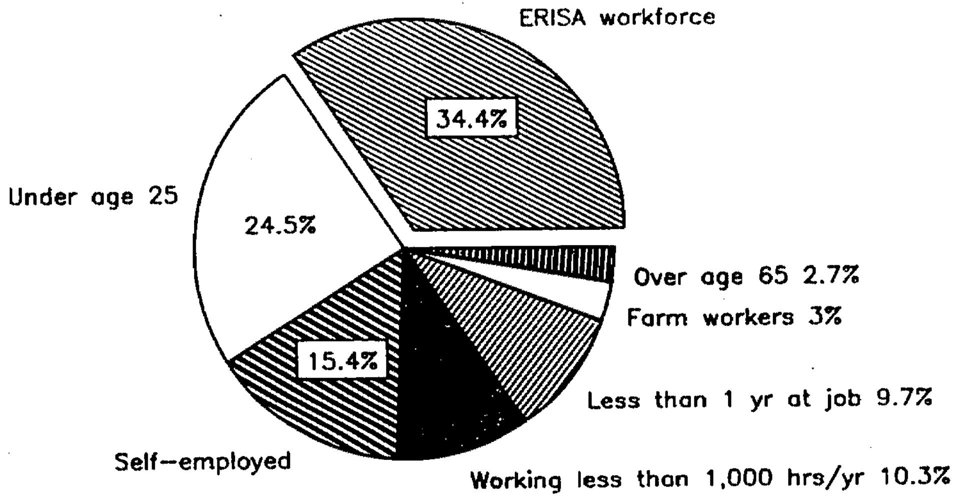
Percent of Non-Farm Private Employees with Pension Coverage, by Firm Size and Unionization, May 1983



Source: Employee Benefit Research Institute

Chart 3

Percent Distribution of Employees Lacking Pension Coverage
Across Employment Categories, May 1983



Source: Employee Benefit Research Institute

Note: "ERISA workforce" consists of all employees not included in other categories (employees meeting ERISA participation standards).

Chairman HEINZ. Thank you very much, Mr. Salisbury.

I note in your testimony, which we have put in the record in full, that you go on to discuss under portability a variety of different types of portability, which I want to bring to the attention of our committee. I am particularly interested in AT&T's experience, where they are trying—I gather, with some difficulty—to bring about the portability of vested credits, which entails a cash contribution from one AT&T former entity to another. I gather they have got a lot of work.

Mr. SALISBURY. It is absolutely intriguing that when AT&T split up, every one of the regional phone companies had an identical pension plan; in spite of identical plans, it took them 9 months to work out the technical details of how to transfer credits. And what they have not yet figured out is, beginning January 1, 1986, when each of the regionals begins going down its own track and changing components of the plan, what portability will involve at that point.

The point I attempt to make in the testimony is that a large degree of the public policy value could be achieved by something that leads to the cash-out and transfer of the cash amount, but assuring that that cash stays available for retirement income, rather than trying to work through the benefit formula problems.

Chairman HEINZ. Mr. Salisbury, thank you very much. I will have some other questions for you.

It is a pleasure to have Judy Schub here, who is becoming an expert witness for the AARP. She has testified before the Senate Committee on Finance, as I recollect, and we are delighted to be able to take advantage of that expertise here today.

I just want to note for the record that prior to joining the AARP—which also have some former staff from the Senate Aging Committee on it, more specifically—and I do not see him here today—our former Staff Director John Rother who, with this committee, is a resource in every sense of the word. We are also going to start charging finder's fees soon. I just want to note that you served as the director of public policy for the National Federation of Business and Professional Women's Clubs, a group I have been privileged to talk to on occasion, and that you have been particularly able and expert in the area of issues of economic concern to women. Please proceed.

STATEMENT OF JUDY SCHUB, LEGISLATIVE REPESENTATIVE, AMERICAN ASSOCIATION OF RETIRED PERSONS, WASHINGTON, DC

Ms. SCHUB. Thank you, Mr. Chairman.

As you probably know, the AARP is the Nation's largest aging organization, representing the interests of 19 million members. The association appreciates this opportunity to contribute to the growing national debate about the future of the private pension system.

The ultimate goal of any changes in the Nation's retirement income system must be the elimination of poverty among older Americans and a reasonable guarantee that older persons will be able to achieve and maintain an adequate standard of living in retirement.

Your first panel of witness is unfortunately very typical. The private pension system is not now meeting the needs of millions of Americans who have spent most or all of their adult life in the labor force. Comprehensive changes are needed.

The system's failure to provide universal coverage, early vesting, inflation, protection, and portability of pension credits seriously limits its importance as a reliable source of retirement income for most workers. The simple fact is that employees earn pension benefits.

In addition there is, as has been noted, an enormous tax subsidy that the system now enjoys. In light of this, we must institute coordinated reforms that will make the system operate more fairly.

In order to receive a meaningful pension, an individual must overcome a series of hurdles. First, an employee must be in covered employment. As Mr. Salisbury noted, slightly more than half of all workers are in covered employment, but coverage varies greatly for different groups of workers. This pattern of coverage means that some groups of workers, such as part-time workers, women workers, are much less likely to be covered. Even if a worker is in covered employment, he or she must vest before they can get any benefits; 87 percent of employees covered by medium and large plans have to work 10 years to vest.

Job mobility is a fact of American life. It is extremely common among younger workers, but also prevalent among middle-aged and older workers.

For example, of workers entering a job at 45, at least 53 percent will not stay 10 years at that job. In 1983, over half of all employees between 35 and 64 had job tenure of less than 10 years. Long minimum vesting schedules do not reflect the real work patterns of Americans and should be significantly lowered.

Even if a worker vests, there is no guarantee that he or she will receive a meaningful benefit. You have heard from one of your earlier witnesses about the impact of integration, which totally wiped out her pension benefits.

The fact is that lower paid employees who face integration will have their benefits substantially reduced, or in some cases, eliminated altogether.

The private pension system as a whole provides very little protection against inflation for those receiving benefits. Few retirees are guaranteed any increase after retirement, with only about 3 percent of all plans providing automatic inflation adjustment. During the 1978 to 1982 period—at time of high inflation—about half of all participants in large and medium plans were in plans that did not grant any inflation increases. Even in times of moderate inflation, most pension recipients suffer a significant loss of purchasing power over a period of time, and the loss is cumulative.

A necessary corollary to any reform in vesting and coverage is a system of portability that allows individuals to transfer vested pension credits. Currently, small vested benefits are often cashed out in lump-sums, and are not preserved for retirement. With shorter vesting periods, this problem would be exacerbated. The need for portability is greatest for low-income workers, who are most likely to spend lump-sum payments and who are most in need of adequate retirement income.

AARP believes that we must now seriously consider expanding coverage, lowering vesting, reducing the impact of integration, building in inflation protection, and establishing a system of portability so that future retirees can look forward to a decent standard of living throughout their lives. Without necessary changes, the private pension system will continue to be an empty promise for most Ameican workers and their families.

Thank you very much.

Chairman HEINZ. Thank you very much, Ms. Schub.

I want to just be sure that your entire statement is put in the record. You excerpted from it extremely well, but there are many points here that need to be elaborated in further depth, so without objection, your entire testimony will be a part of the record.

[The prepared statement of Ms. Schub follows:]

PREPARED STATEMENT OF JUDY SCHUB

INTRODUCTION

The American Association of Retired Persons (AARP) is the nation's largest aging organization representing the interests of over 19 million members. The Association appreciates this opportunity to contribute to the growing national debate about the future of American's private pension system.

The ultimate goals of any changes in the nation's retirement income systems must be the elimination of poverty among older Americans and the reasonable guarantee that older persons will be able to achieve and maintain an adequate retirement income. To be adequate, an older person's income should be sufficient to prevent a significant decline in his/her living standard after retirement. Social Security must continue to be relied upon to provide an important component of older persons' income. But, to achieve adequacy, Social Security will have to be supplemented by income from other sources, especially private pensions.

The current private pension system is not meeting the needs of millions of Americans who have spent all or most of their adult lives in the labor force. Despite the enormous tax subsidy that the system now enjoys ($40 billion in 1985) it is not now reaching most retirees and, without major changes, will not be a significant source of income for future retirees.

Comprehensive changes are needed in the private pension system. The system's failure to provide universal coverage, early vesting, inflation protection and portability of pension credits seriously limits its importance as a reliable source of retirement income for most workers. The simple fact is that employees earn pension benefits, and contributions to plans are made in lieu of direct compensation. Pension benefits are no longer a reward, but a right, and the employee is entitled to the benefits of that right. Therefore, we must now institute coordinated reforms that will make the system operate more fairly.

Despite the popular myth that the elderly are "wealthy," millions of older Americans are living in poverty or are perilously close to the poverty line. In 1983, the poverty rate for the elderly was 14.1 percent, representing 3.7 million people. Over one-fifth of the elderly are poor or have incomes below $1,000 of the poverty line.

Older women tend to be one of the most vulnerable groups among the older population. Overall, 10 percent of men over 65 were poor in 1983, compared to 17 percent of older women. Older women comprise nearly three-quarters of the total aged population in poverty. The threat of poverty is even greater for minority older women—two-thirds of elderly black women living alone had incomes below the poverty line.

One important factor in the economic vulnerability of the elderly is their dependence on Social Security for most or all of their income. While over 90 percent of the elderly receive income from Social Security, only one in four receives any private pension income. Sixty-six percent of the elderly receive 50 percent or more of their income from Social Security; 28 percent receive 90 percent or more from Social Security.

A study of recent retirees shows that while the percentage of individuals receiving private pensions has increased, the amount of private pension income is still very low. For recent retirees, 38 percent of married couples and 26 percent of unmarried individuals received some private pension income. But, half of the couples and two-thirds of the unmarried individuals received no more than $100 a month from this source. Clearly, private pension income is not yet an important component in ensuring adequate retirement income.

In order for a worker to receive a meaningful pension, he/she must first overcome a series of obstacles. Consider the following examples:

John Smith works 45 years for small companies that do not have pension plans. He retires at age 65 with no private pension and is totally dependent on Social Security and a small amount of savings.

Mary Jones works as a secretary for a large corporation for nine years when she is in her twenties, but leaves to raise a family. She returns to the workforce when she is 36 and works for four different employers. Mary Jones never vests in a pension plan and retires at age 65 with no private pension income from her time in the labor force.

Paul Brown works more than ten years for three different employers. Paul Brown retires with several very small pensions.

Ann Black works 10 years for her final employer at an average salary of $15,000. She expects to get a pension of $150 a month from this employment, but finds that because her employer has integrated her Social Security and pension benefits, she will receive no private pension.

Peter Gray retired in 1975 with a private pension of $300 a month. His plan has no automatic inflation adjuster and the plan has only granted two ad hoc increases in the past ten years. His pension is now worth far less than when he retired.

These examples illustrate the most common pension problems, all of which must be addressed to ensure pension adequacy.

COVERAGE

In order to receive a pension benefit, an employee must be in covered employment. Approximately half of all workers are covered by a pension plan. But, coverage varies greatly for different groups of workers. Workers who are unionized or employed by large firms are most likely to be covered. Part-time workers can be excluded from coverage as can new employees who are nearing retirement age. This pattern of coverage means that some groups of workers are much less likely to be in covered employment. For example, women make up two-thirds of the part-time workforce, are heavily concentrated in occupational areas where there are fewer pension plans, are most likely to work for small companies and are not generally in unions.

It is important to expand coverage so that more workers can have a chance to qualify for a pension. But, being in covered employment is no guarantee that an individual worker will ever receive a benefit that halps maintain an adequate standard of living or any benefit at all.

VESTING

The first barrier that an individual in covered employment faces in earning a pension is vesting. Many plans use ten-year "cliff" vesting—employees get no benefit unless they are in the plan ten years. In 1982, 87 percent of employees covered by medium and large plans had to work ten years to vest.

Job mobility is a fact of American life. It is extremely common among younger workers, but also prevalent among middle-aged or older workers. Of full-time male workers entering a job at age 25, 67 percent will leave before ten years; for those entering a job at age 45, 53 percent will not stay ten years. In 1983, over half (54.1 percent) or all employees between 35 and 64 had job tenure of fewer than ten years. (Forty-five percent of men and 66 percent of women had less than ten years of service at their current jobs.) Long minimum vesting schedules do not reflect the real work patterns of Americans. The mobile worker has as great a need for retirement income as the worker who stays with a single employer. Yet because of lack of vesting, the mobile worker may receive no pension or only a small pension from his/her last employer.

While immediate vesting, at least for a minimum benefit may be the ultimate goal, it is clear that a vesting period significantly less than ten years is essential. Some may argue that the cost increase is too great, but the need to move toward greater protection far outweighs the costs involved. Donald S. Grubbs, Jr., a consulting actuary, estimates that three-year vesting would "create increases in cost for most defined benefit plans ranging from 0 percent to 10 percent of present plan costs and from 0.0 percent to 0.3 percent of compensation of covered employees." But he goes on further to state that "the cost increase is small and affordable, and this disadvantage is outweighed by the need for early vesting."

In 1983, slightly more than half of all covered workers had vested in a pension plan. (Since only half of all employees are covered, this means that only 25 percent of the total working population had acquired a right to receive benefits.) But, even when an individual has vested, he/she may never receive a meaningful benefit because of Social Security/pension integration, lack of inflation protection, loss of accruals after age 65 and the absence of a system of portability.

INTEGRATION

Many pension plans integrate Social Security and pension benefits, reducing an individual's pension by some percentage of their expected Social Security benefit. (Fifty-five percent of participants in medium and large firm plans are covered by plans that integrate.) While private pension plans must not overtly discriminate against lower paid employees, a plan may consider contributions to Social Security or expected Social Security benefits in determining benefit amounts. The end result of the practice of integration is that lower paid employees may have their benefits substantially reduced or eliminated altogether.

While Social Security is weighted toward lower paid individuals, it is clear that those with low incomes need the supplementary retirement income provided by private pensions to maintain an adequate standard of living. The general thrust of tax code provisions and pension law has been to expand broad receipt of benefits. It is thus inconsistent and unfair to allow plans to integrate with Social Security so that lower paid workers receive little or no benefit. In addition, the fact that plan participants pay for pension benefits through reduced wages makes it difficult to justify denying earned benefits to lower paid workers.

LACK OF INFLATION PROTECTION

Another factor mitigating against a retiree receiving a meaningful benefit is that the private pension system, as a whole, provides very little protection against inflation for those receiving benefits. Very few retirees are guaranteed any increase after retirement. For example, 49 percent of participants in large and medium plans were covered by plans that did not grant any ad hoc post-retirement increases in the 1978-1982 period. While many plans do provide ad hoc adjustments, only about three percent of all pension plans provide automatic inflation adjustments. Even these adjustments are usually limited to a maximum of about three percent a year. The average American retiring at age 65 has a life expectancy of about 17 years. If one assumes an inflation rate of five percent, the average pension recipient will suffer a 56 percent reduction in purchasing power to his/her fixed pension in 17 years. Higher rates of inflation will be even more devastating.

If the future elderly are to be better able to maintain their living standards throughout their later years, ways must be devised to mitigate the effect of inflation on private pension benefits. Possible inducements for employers to provide some inflation compensation include the extension of federal labor law to specify that retirees' benefits are a mandatory subject of collective bargaining and the issuance by the Federal government of indexed bonds that would be available to private pension plans and would guarantee a real rate of return on investment. In addition, retirees must have the opportunity to take part in their pension plan's decision-making process to promote cost-of-living protection when funds are available. With the increasing termination of pension plans by employers to recover excess assets, ways should be explored to allocate some part of the excess to plan participants and retirees. Using excess assets to reduce the negative impact of inflation on post-retirement benefits is rational in light of the fact that high interest rates associated with high inflation rates helped account for the surpluses.

ACCRUALS AFTER AGE 65

An additional problem that employees face is that if they choose to continue working after age 65, they may accrue no further benefit and may actually lose some of their benefits if the plan's payments do not start until after the worker actually retires. Current Equal Employment Opportunity Commisison (EEOC) regulations adopted from the Department of Labor, have allowed employers to give no additional pension credits to workers who continue employment beyond age 65. Recently, the EEOC rejected this interpretation as contrary to the Age Discrmination in Employment Act and proposed new regulations that would require accrual beyond age 65. If the proposed regulations are implemented it would halt the practice of nearly half of all pension plans that currently freeze pension credits at age 65.

PORTABILITY

A necessary corollary to any reforms in vesting and coverage is a system of portability that allows individuals to transfer vested pension credits. Currently, a small vested benefits are often cashed out in lump sums and are not preserved to provide retirement income. With shorter vesting peroids, this problem would be exacerbated, and the objective of providing an adequate retirement income would be fraustrated.

One potential approach is the establishment of a central clearinghouse, that could act as a "bridge" between pension plans so that when workers change jobs, funds can be transferred and maintained for retirement needs. Another possibility is the requirement that any lump sum be deposited in a rollover IRA, with access denied until retirement. Either approach would relieve the potential administrative burden placed upon the employer attempting to administer a number of small vested pensions.

The need for a system of portability is greatest for lower income workers, who are most likely to spend lump sum payments, and who are most in need of an adequate pension in the future. With a workable system of portability, earlier vesting becomes more practical and mobile workers in general will have the opportunity to receive a retirement income based on total years of employment.

CONCLUSION

AARP supports reform and expansion of the private pension system so that it becomes, over time, a more universally available and more reliable source of meaningful retirement income for older Americans.

We must now seriously consider options for expanding coverage, lowering vesting, reducing the impact of integration, building in inflation protection and establishing a system of portability so that future retirees can look forward to a decent standard of living throughout their lives. Without necessary changes, the private pension system will continue to be an empty promise for most American workers and their families.

Chairman HEINZ. Let me start with Mr. Salisbury.

Dallas, you noted in your testimony that earlier vesting with lump sum distributions allowed would not increase retirement income, and Ms. Schub has made the same point.

If the Congress were to prohibit pre-retirement distributions—assuming we wanted to make that kind of tough choice—would you agree that earlier vesting would increase pension income?

Mr. SALISBURY. I would rephrase. It might, even without changing the distribution rules, because for some employees, the additional vested benefit might well kick them above the $3,500 limit in the law.

But for many of the 1.9 million additional people who with 5-year vesting, would immediately vest, the surest way to give them additional retirement income would be to tell that employee: "Even if you get a cash distribution from the plan, your only option with that check is to put it into another plan or into an individual retirement account," or basically to restrict that employee's action. An other area where the implications of that type of action could be dramatic is with the Federal employee pension system. A very large percentage of those who leave the Federal work force with a vested benefit immediately withdraw all of the contributions they made to the plan, which forfeits their right to all of the vested benefit under the employer-paid portion of the program. So it is an employee choice option, if you will, that needs to be restricted as much as what the employer can do. And it would increase retirement income in many cases.

Chairman HEINZ. Suppose an employee comes and says to us, in a sense, like Mr. Sprague—really, it did not work out quite that way in his case—but he says, you know, the way for me to provide for my retirement benefit is to go and start my own business in Florida, and I will be able to start a Keogh Plan, and I will eventually live happily ever after. I have worked for this employer, and there is a lump sum amount there. It will give me my start in life, and that is really what I want to do with it. And if you, the Congress, don't let me do that, you are telling me that I really cannot go out and work for real independence.

How do you answer that one?

Mr. SALISBURY. I noted in my full, prepared statement, Senator, that for many years, there has been a conflict between two particular aspects of the tax preferences for employer-sponsored plans. Many of the code provisions attempt to push in the direction of retirement income programs per se, and then a whole companion set, of incentives clearly defined in ERISA, while having the hope of eventually providing retirement income, are principally there to provide a tax incentive for people to save: for special needs, for financing education, for buying, for going to open that business and that type of thing.

Frequently, we find ourselves where we are judging that set of so-called capital accumulation plans as "failures" if they do not produce retirement income. And I think that is an area where you and the Congress need to clearly decide how you want to balance those particular objectives, because there is a reason, and the Congress has clearly recognized the reason in the past, to allow that employee that type of choice. But if you allow the employee that choice, you do not then want to view that as a failure of a pension system, if you will. And so it is that clarification of objectives that is needed. And if the objective of the tax subsidy that has been identified—and as you note, for the private employer community, as the budget calculates it, $25 billion a year—is the Government providing that subsidy for dual purposes to allow the prior witness to have the money to start that business in Florida; do you want to subsidize that through that savings plan? Or, should the subsidy be targeted to retirement income? And this is a comfortable case where I can say, it is your choice.

Chairman HEINZ. It surely is, which is probably one of the reasons it has been so difficult to get the Congress to face up to the issue, because it is one of the toughest kinds of choices that you can ask Congress to make, which is how do you kind of square the circle between security and freedom of choice. That is one of the great tensions in our society. But I will tell you this. We are very lucky we have that pension. It keeps the wolf away from the door, and it is a lot better than the alternative of having no pensions and choices at all.

Mr. SALISBURY. You will get no disagreement on that.

Chairman HEINZ. You know, the analysis prepared by this committee suggests that the decline in average job tenure, the mobility of our society, and so forth, is going to result in less vesting in the future if pension plans continue to use 10-year cliff vesting. Would you agree with that assessment?

Mr. SALISBURY. In a 10-year cliff vesting situation, that would clearly be the case. I think there is one way that most employers are dealing with that short-term worker versus long-term worker issue. Increasingly, the larger employers, have more than one plan. They have a defined benefit plan, and the objective of that plan is to provide retirement income to longer service workers. And they supplement it with a defined contribution plan that tends to have a much shorter vesting schedule, to accommodate that higher turnover with vested right under the defined contribution plan.

There is no problem with that, if you will, if one is looking simply at the equity of giving people back money that was contributed on their behalf and not worrying about what the people would do with the money; then that is a fine system.

Chairman HEINZ. What you are saying is that defined contribution plans—let's take the most favorable case—defined contribution plans that do not permit any cashing out of the plan, and contributions have to be used to pay some retirement benefit at some age later on—are not going to result in a great deal of retirement income.

Mr. SALISBURY. If the cash out must go to retirement, it will result in that. But if that is not a requirement, then it may or may not. The current population survey that—the Employee Benefit Research Institute—spent a lot of money having the Census Bureau take, along with the Department of Health and Human Services, after an excellent analysis that your staff and my staff have both done, indicates that over 70 percent of lump-sum distributions received at a preretirement age are consumed; only about 30 percent are in any way saved, of which only a small portion is actually identified by the people as being saved for retirement income.

So, if the objective is retirement income, then there is a problem there. If the objective is purely capital accumulation and savings, then there is no problem.

Chairman HEINZ. Ms. Schub, you mentioned in your testimony that older women tend to be the most vulnerable among the elderly. How do the pensions problems you have discussed contribute to this vulnerability?

Ms. SCHUB. Well, as you heard from your first panel of witnesses——

Chairman HEINZ. I suspect it was no coincidence that three out of four of our panelists were women.

Ms. SCHUB. Yes; the problem in coverage is that women do have shorter job tenure than men, and one of the reasons is that women—even if they spend most of their adult lives in the work force—do take breaks for family responsibilities, so they have breaks in their employment record. They also make up two-thirds of the part-time work force. They also make lower wages. And, since pension benefits are based on earnings, if they receive a pension at all, they will receive a lower pension and be even more at risk because of inflation. So there are a series of reasons why women tend to be less likely to get a pension, even if they work their entire lives, and to receive a smaller pension.

Chairman HEINZ. Let me ask you about some of the specifics of the witnesses. Mrs. Boley described how plan integration did her out of any pension benefit and you did state in your testimony that you believe it is inconsistent and unfair to allow plans with integration features so that low-paid workers—$3.38 an hour, after 20 years, is certainly a low-paying job—to deprive a worker of their pension.

Do you feel that integration should be totally prohibited, or is it enough to guarantee that workers receive at least a specified portion of their pension benefit in the event of integration?

Ms. SCHUB. The Association is looking at the options ranging from total elimination of integration and what impact that would have on plans and on individuals, to the various proposals that have been made relating to minimum benefit, making sure that there is a better distribution of benefits amongst lower and higher paid workers. And we have not chosen one and said, OK, this is the way we have to go.

Chairman HEINZ. If we were to act today, would we be well advised to kind of do half the job rather than the whole job?

Ms. SCHUB. I feel that that is a question I cannot answer, that we have to really look at it. Maybe the answer is to totally eliminate integration, but I have a feeling that my colleague on this panel would argue that that might be a disincentive to plan formation and lead to even further plan termination.

Chairman HEINZ. Let's hear what he has to say on that subject.

Mr. SALISBURY. I think that most sponsors, particularly the sponsors of the large plans that provide for 82 percent of their workers at least, would tell you that total offset integration, which is the case that was discussed at this hearing, is something they do not do, something they do not believe in and frankly, probably, they would tell you it is something that they do not think should be allowed.

On the other hand, I think they would tell you, and that the literature would clearly argue, that some form of integration, implicit if not explicit, is in fact going to take place. The implicit integration cannot be outlawed, that is, the plan setting some target of income that they're going to try to shoot for. The explicit integration, the formula that deducts a certain amount of Social Security and that type of thing, is another matter. I think you would find argument that at the 50-percent offset range—or something such as that—you are going to gain maximum efficiency for the system, if the goal of retirement income is the desirability of replacing for most workers 80 percent or 90 percent or 100 percent of their total income. Social Security, as we know, has a redistributional benefit formula. It provides much higher replacement at the lower income levels than at the higher income levels. And one could at least make the theoretical argument that one reason that many people who tend to be more involved in the policy process are more than happy to see the Social Security system function that way is because it does integrate, if you will, with the employer system in some way, as well. But as far as totally freezing somebody out of a dollar of benefit—the large companies, the firms employing more than 500 employees, it can safely be said of them that if you went to the groups lobbying on their behalf, they would say the total offset form of integration is unfair, undesirable, and should not be allowed. But I will not tell you that, because I am not supposed to.

Chairman HEINZ. All right.

Ms. Schub, you agreed in your testimony with Mr. Salisbury that earlier vesting can improve pension benefits only if the workers are not allowed to cash out their benefits.

Ms. SCHUB. Yes.

Chairman HEINZ. How could we change the IRA rollover provisions to prevent a loss of benefits without restricting portability?

Ms. SCHUB. Well, there are a number of proposals that I am sure you have heard about—for a central bank, which would be a place that workers could rollover pension benefits to and then move to new plans as those new plans are willing to accept them. We are obviously looking at some greater penalties than are in current law if an individual puts his money in an IRA and then cashes it out. There is an excise tax, but it is not that big a disincentive to do that.

I think there are some very hard choices. As you said, it is a choice between balancing individual choices and freedoms against what we know is going to be a societal need to have people who have adequate retirement incomes.

If we do not do it, we are looking at demand in the future on the Government, on the Social Security system, which many people would now say is barely providing for millions of Americans. We cannot really look at increasing that burden in the future. So we are faced with some very tough options——

Mr. SALISBURY. Senator, if I might just point out one thing, in the context of the law, the so-called rollover IRA is a separate entity from a normal Individual Retirement Account. So it would be possible to basically have one set of requirements for rollover IRA's and a separate set of requirements that applies to the IRA that the individual chooses on their own to set up with some dollar amount. There is already a very clear distinction between the two in the law, and that distinction for this purpose could simply be, if you will, made a little more precise.

Chairman HEINZ. Very well. I want to go back to something that we were talking about on defined benefits and defined contribution plans. Ms. Schub, in your statement, you were talking about the need to have some inflation protection. Mr. Salisbury was saying that if you, in a sense, enrich plan benefits, defined benefits too much, say, by eliminating integration, employers might not offer defined benefit plans.

Are you proposing that there be some kind of inflation protection in both defined benefit as well as defined contribution plans?

Ms. SCHUB. Yes; we are. And again, we are looking at——

Chairman HEINZ. How does that work with a defined contribution plan?

Ms. SCHUB. Well, you do have some assets accumulating over time. While you have one set of persons retired, you have a new set in the work force with contributions being made. And they usually are some projections on earnings which may be underestimated. Of course, we are hearing a lot about defined benefit plans, where the projections on earnings have been extremely underestimated, and so there are excess assets in those defined benefit plans which are being recaptured by companies.

An example of a defined contribution plan which promised a 2-percent return on investment to its retirees and has never paid that little is TIAA-CREF, which is one of the largest pension plans in the country. It is technically a defined contribution plan, with a minimum defined benefit at the end. They have, over the years, as I said, never in their history paid as little as 2 percent. They have very conservative investment advisors who are saying they are only going to get a 2-percent return on their investment. Well, that has not been the case. And because they are a nonprofit plan, they do then distribute the additional amongst persons reaching retirement.

Chairman HEINZ. I am just thinking, if people were running their defined contribution plans kind of normally, wouldn't the actual answer be that you would get lower initial benefits?

Ms. SCHUB. That is one way to do it—to have lower initial benefits and building in some sort of inflation protection.

Chairman HEINZ. I guess I have one last question for you. In the case of Madeline S., who never got a chance to participate in a plan, much less vest, what should we do about that situation? That plan was never challenged by the IRS. If Congress wanted to prevent that kind of thing from happening, how would we change the law?

Ms. SCHUB. First of all, we have to look at the exceptions where you can exclude a class of workers. And we do know of cases where the only workers excluded are clerical workers, all of whom happen to be women. It is not discrimination against lower paid employees, because there are other workers in the plan who are lower paid employees. We have to look very carefully at the exclusions which are now allowed, and very possibly end them, because I think that is where the problem has come in. Her employer was using an exclusion to say that hourly workers could be excluded. If they are not in violation of the law, they had other low-paid employees who were included in the plan.

Chairman HEINZ. Do you have anything to add to that, Dallas?

Mr. SALISBURY. In the large business setting, I think you would have to simply change the terms under which groups could be excluded. In the small business setting, it is a more far-reaching problem. As far as how to get small employers to have pension programs, I think you have to go back to the report of the President's Commission on Pension Policy. After all sorts of analysis, they basically concluded that there is only one of two ways to get the broad range of employers to go that route. Their conclusion was either that you mandate a plan at a minimum level, or their other recommendation was that the Congress provide a 100-percent tax credit for the contribution to the plan.

Chairman HEINZ. A 100-percent tax credit?

Mr. SALISBURY. One hundred percent. The revenue loss attributable to that was rather large. Our analysis indicated that dollar for dollar and pound for pound, you would be better off increasing the Supplemental Security Income [SSI] payment or the minimum Social Security benefit than to go that route.

So to answer your direct question, among those employers who already have a plan, it is the relatively simple approach of saying you have to cover all groups if you want to get there.

Chairman HEINZ. Thank you.

I want to note the presence of a very valued member of our committee, Senator Warner of Virginia. Senator, we have heard from a panel of witnesses. I hope the staff provided you with the background on both panels.

Senator WARNER. Yes.

Chairman HEINZ. I have completed my questions, and you can make an opening statement, closing statement, questions, whatever you would like to do. We welcome you to the hearing.

Thank you.

Senator WARNER. Please proceed with the next panel, Mr. Chairman. I have no questions.

Chairman HEINZ. Thank you very much.

Our next and last panel will be Mr. Harry Smith, of the Sun Co.; Alan Reuther, the associate general counsel of the United Auto Workers, and Jack Sheehan, John J. Sheehan, of the United Steelworkers.

Jack Sheehan has been the director of the Steelworkers' legislative department not only as long as I can remember it, but I am told, since 19—well, I will not even begin to say—18 years. We had a steel industry when he became director of the legislative department.

I do not know whether that is cause and effect, or what, Jack. [Laughter.]

Let the record show that the chairman smiled as he said that.

Mr. Smith, we welcome you. You have been working for the Sun Co. for the past 35 years. I understand you are retiring at the end of this month. And you have been the director of special projects, you have had a lot of experience in the capacity of planned administrative employee benefits at the company. I am told that if there is anything that has ever happened at the Sun Co. that has to do with employee benefits, pensions, or any of this, the only person who either knows that fact or remembers that fact is going to be you. That is a tremendous accumulation of wisdom, and we are delighted to have you here. The Sun Co., of course, is domiciled in my home State, the Commonwealth of Pennsylvania.

Thank you for being here. Please proceed.

STATEMENT OF HARRY G. SMITH, RADNOR, PA, MANAGER, SPECIAL PROJECTS, SUN CO., INC.

Mr. SMITH. Thank you, Mr. Chairman.

My name is Harry Smith. I represent Sun Co. Sun is one of the smaller energy companies located in Radnor, PA.

I am a little apprehensive, Senator. I feel just a wee bit like a red-headed, freckled, buck-toothed, illegitimate child at the family reunion—I am not sure I am welcome, because the story I have to tell is one of tremendous success.

Chairman HEINZ. That is why you were invited to the party.

Mr. SMITH. Well, I am glad to be here.

Over the years, Sun indeed has developed a total philosophy of benefits, and it is simply that benefits are part of total compensation, and as such, in the aggregate, they should be competitive in our industry, they should be competitive in our localities, and the benefits should cover the basic needs of employees. We really have not gotten too fancy with the reimbursement accounts and all these things, but the basic needs, we feel, must be covered. In those, we cover, of course, retirement, health, premature death, time off with pay, capital accumulation, and medical—for heaven's sake, medical, which is getting to be a bigger and bigger problem all the time.

Sun believes that the employees should be encouraged to participate in their economic security, and we do it two ways. We provide dollar-matching savings plans, and we provide financial management of the plans. So we encourage sort of the "three-legged stool", because we believe government has a legitimate role, that role being in Medicare, Social Security, and in tax incentives which will encourage the development and maintenance of these other plans.

This is a natural philosophy that grew out of a very stable industry. Heavens, when I started, you could sit down, and unless you got hit by a truck, you knew where you would be 22½ years from then. The world was a very comfortable world. You got married. You even stayed with the same wife and built a home, lived in the same home, and everybody had a goal of home ownership and getting the kids through college.

We started a stock plan—I was not around for this; Mr. Pew did—in 1926, he started the stock purchase plan, and that really built many, many homes. But better than that, it built many, many college educations for kids of employees.

Sun really does not subscribe to the principle of indexation of pension plans. Personally, I think it is inflationary by definition. On the other hand, you know, life being what it is, we saw pensions eroding, and I guess all my life, since I have been in the company, we have granted increases in pension benefits, even back in the days when we had an informal unfunded plan. And we have granted 10 ad hoc increases since 1960 in the formal sense. These ad hocs are always built into the pension base and continue there for the life of the retiree.

More recently, we came up with a system we call ORBIT. ORBIT was named because of my frustration with inflation. I felt the CPI was in orbit, so one of the younger men in the company said, "OK, we will call it the Optional Retirement Benefit Income Trust."

We like optional things, we like "voluntary" in our company, and so we said to the employees, "If you pay part, we will match it, and you can buy an annuity which will index your pension plan, and when you get there, retirement, you will have protection."

Now, this is currently in the legislative program somewhere, and I understand that Senator Chafee may be reintroducing it. We would hope it passes, because it is a voluntary way for industry to help solve this problem without burdening any further the public sector. So we think it is a good idea.

Now, all of a sudden, this world is changing. The old security, the old lifetime career, is gone. You have the two-wage-earner family, you have the single-parent family, you have mobility for the young gentleman over here, who indeed was young, at that age when he decided he wanted a mobile life. Of all the problems on the table in that first panel, I think I could have solved all of them except maybe two. This gentleman said he did not have any plans. If you do not know where you are going, any road will get you there, anyway. So you have got to have goals for your personal life, and corporations have got to have goals in order to get anywhere.

So all these things have changed. We do not live in the same neighborhood. Everybody is working. We all have trouble with the baby boom moving through the work force and getting to the baby bust.

All of us in industry are really sweating it out. How do we handle these things?

If you have a defined benefits plan, it is true that the accruals in the early years are low, and you work toward a career, and when you get there, if you stay there in the same company, things are fine. "I am not going to apply for foods stamps next month; I will just wait and get my check."

On the other hand, if people are not going to be in the same company very long, if they are going to have this mobility, then perhaps a defined contribution plan should be looked at.

I agree with Mr. Salisbury that early vesting, or more liberal vesting schedules, will only spread poverty if you allow lump-sum distributions. Now, if you can contain the distribution at low levels—you know, reduce $1,750; instead of doubling it, reduce it—because money set aside for pensions in our view should be left there, and the tax incentives, I would hope, would be set up for that purpose.

So these issues arise with the changing world. If you are going to have people moving, what can we do, what can Congress do, what can the private sector do, to have pensions available, pension adequacy, in all cases? And I am not sure whether it is earlier vesting, or liberal vesting schedules, defined contribution plans. But I am certain that money set aside ought to be left there for pension purposes. And in our case, we have a defined benefits plan. We do not provide for lump-sum distributions. Then we have a 401(k)-type plan, and distributions may be made there, but they do not have to be, so an employee has an opportunity for capital accumulation aside from a pretty liberal pension plan.

As far as the Government is concerned, we would hope for a more stable regulatory climate. We have had considerable changes over the years, and it is sometimes difficult. Sun has almost as many retirees as we have active people, and as I told you before, I consider this a success story. We keep in close touch with them, and we feel that the plan benefits have been adequate. We keep a medical program available for them, the same program you have as an active person until age 65, then they have Medicare and a wrap-around medical plan. The same is true of life insurance. It stays at the same level to 65, then drops off in 5 years to about $8,000, I believe.

So, we would hope that the Government would give us a more stable regulatory climate, but continue to provide tax incentives to encourage these programs and encourage employees to help themselves, encourage private industry to help the employee, and then encourage these plans that provide adequacy at retirement.

I believe that at the moment, that is about all I would like to say, except if questions permit, I would like to comment on some of the difficulties here. I think there is an area that Sun does pretty well at that might be interesting to you, and that is in the administration of plans, we would not allow some of these things to happen.

Chairman HEINZ. Mr. Smith, thank you very much. We will come back to you for some questions.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF HARRY G. SMITH

Over the years Sun has evolved a basic philosophy with respect to employee benefits. Sun believes that benefits are a part of total compensation and that is the aggregate this compensation should be competitive in our industry and in our geographic areas. Sun believes that these benefit programs should include plans for capital accumulation, premature death, medical care, disability income, retirement, paid time off, etc. Further, Sun believes that its plans should encourage employees to plan and save for their own economic security. Sun also believes that the government has a legitimate role to play in ensuring basic economic security through programs like Social Security, medicare and by providing reasonable tax incentives to stimulate additional necessary benefits.

This philosophy was a natural one for Sun where employees hired on for full lifetime careers. In those days petroleum was a stable industry and industrial life was very predictable for Sun and its employees. Most families had one bread winner and home ownership and college for the children were goals for most. Sun's stock purchase program, started in 1926, financed many homes, and put many of the sons and daughters of Sun employees through school. With respect to retirement programs, Sun provided retirement income through an unfunded and informal basis at first, and then, since 1965, on a funded and formal basis. Sun's retirement plan today provides benefits integrated with Social Security and based on final pay earned just prior to retirement. As a result, income replacement at retirement is at a level that, together with government programs, company sponsored savings programs, and personal savings, enable a retired employee to live at about the same standard he/she maintained during his career.

Although Sun does not subscribe to the principal of indexation, Sun has over the years provided ad hoc adjustments to retiree benefits in order to offset the erosive effects of inflation. We have granted approximately 10 ad hoc increases to retiree pensions since 1960. Today, we have a system we call ORBIT where employees who wish to do so may use part of their thrift plan account to purchase an annuity which will provide inflation protection. Sun matches employee contributions dollar for dollar to purchase the annuity at retirement. We feel so strongly about the need for this program that we have been working hard for the last three years to enact legislation which will permit greater flexibility in the provision of these benefits. This legislation, which permits what we call supplemental retirement benefits to be provided more efficiently, will be reintroduced in the Senate shortly by Senator Chafee. Sun also makes health insurance available to retirees and a modest amount of terminal life insurance. Sun maintains contact with its 10,000 or so retirees and reviews with them the environment in which the company operates and endeavors to meet their needs. The principal underlying these programs is basic. Sun encourages employees to help themselves by providing Company supported thrift plans and adds financial and management support of the employee's efforts.

This world, however, is changing. Those in many mature American industries can no longer look forward to full lifetime careers, to a stable industry, to a stable regulatory climate, to living in our own homes in the same neighborhood with our wives minding the children. The two wage earner family, the single parent family, new housing patterns, and greater mobility, have reduced the need to identify with one company, or even one industry. The "baby boom" generation moving through the workforce, to be followed, we are told by the "baby bust," creates further burdens of planning for the next thirty years.

Sun and, we suspect, many industries, are seeking ways to accommodate our changing world and the changing needs of our employees. For example, does greater mobility mean we should move away from income replacement concepts provided by defined benefit retirement plans to defined contribution concepts which benefit shorter term workers and produce benefits which are highly portable? If so, what becomes of pension and benefit adequacy at time of retirement? Should the mobile worker with "portable benefits" be required to roll over lump sum benefits to ensure use of money for retirement purposes or should lump sum distribution be freely permitted without restriction? Defined contribution plans are more costly. How should these increasing costs be allocated? How should spouses and dependents benefits be handled under defined contribution concepts? If normal retirement no longer carries the same meaning today when career employees are less and less in evidence, what is a company's obligation to provide retirement linked benefits such as post retirement medical or post retirement ad hoc pension increases?

In the welfare benefit area defined contribution concepts are also becoming popular because of our changing environment. Benefit costs, particularly medical benefits, have skyrocketed. Plans such as cafeteria plans are attractive because they permit an employer to fix the amount of money it is willing to devote to covered benefits and shifts the choice of benefit levels to employees. How do we protect employees from making bad choices?

Movement to these concepts is not bad per se. Many have criticized employer paternalism over the years; but the decline in paternalism will lead to employees being put at a greater risk as to key benefits. How does an employer design a system which minimizes both? These are the kind of issues with which Sun and other employers are struggling.

Government also has a constructive role to play by providing policy and incentives that permit employers and employees the flexibility to make necessary choices and also to promote adequate benefits which are fairly distributed. To date that has not been the case. With shifting public policy emphasis—one day seemig to favor DC plans and the next day favoring DB plans—one day favoring savings incentives the next day, retirement—government action negatively impacts industries' ability to strike a balance between employee needs, costs, and the changing work environment.

We believe that government should provide reasonable tax incentives to promote benefit plans which meet the basic needs of employees. We also believe that these incentives should encourage that amounts set aside by employees or employers for retirement purposes remain in the retirement system. However, public policy must be sensitive to the fact that employees have needs prior to retirement and will not participate in savings programs where their dollars are inaccessible. Sun has addressed this problem in the past by preventing lump sum distributions from its retirement plan, while permitting such distributions from its savings plan. We feel that this is fair. However, we also believe that where there is only a single program, whether defined contribution or defined benefit, an employer's first priority is to see that sufficient funds exist to ensure reasonable retirement income for its employees.

Lastly, the pace of legislative change placed upon industry needs to be slowed. We've had reform in this area in 1969, 1974, 1976, 1978, 1981, 1982, twice in 1984 and an expected reform in 1986. We are not happy with the need to implement and re-implement these new statutes and new regulations. Major changes require enormous design, systems, communications and employee relations efforts. Often even well-intended legislation is drafted without regard to simple business realities. Neither employers nor employees can plan in such an environment. Many times before a change has been completed a new change in the same area is being required. We in industry ask you to be more sensitive to these problems.

Chairman HEINZ. Let me now turn to Alan Reuther.

Alan.

STATEMENT OF ALAN V. REUTHER, WASHINGTON, DC, ASSOCIATE GENERAL COUNSEL, INTERNATIONAL UNION, UAW

Mr. REUTHER. Thank you, Mr. Chairman.

My name is Alan Reuther. I am associate general counsel for the United Autoworkers Union. The UAW appreciates the opportunity to testify before this committee, concerning the adequacy of the private pension system in providing retirement income security for the elderly.

We believe that the adequacy of the private pension system cannot be judged in isolation. It is necessary to consider the pension system in conjunction with the other mechanisms for providing the elderly with retirement income security—namely, Government programs such as Social Security, and individual savings vehicles, such as individual retirement accounts.

In our judgment, there is a compelling need for Congress to develop and clearly articulate a stable, consistent national retirement income policy that deals with the relationship between these three approaches toward providing the elderly with retirement income security.

The UAW commends you, Mr. Chairman, for the leadership which you have displayed in attempting to fashion such a comprehensive national retirement income policy, and we look forward to working with you in this endeavor in the coming months.

Social Security remains the base upon which retirement income security is built. It provides almost universal coverage to the private work force, has the advantage of complete portability, and is the fairest and most efficient way to provide essential retirement income benefits to our Nation's senior citizens. Two-thirds of the over-65 beneficiaries rely on Social Security for more than one-half of their income; a third of this age group rely on Social Security for more than 90 percent of their income.

Since most Americans rely heavily on Social Security, the UAW believes that more emphasis should be placed on making benefits under the program sufficient so that retirees can live in dignity, rather than on the brink of poverty. In particular, we believe the percentage of preretirement income replaced by Social Security must be raised for lower income workers. These workers have the least resources with which to provide for retirement security through personal savings, and they are also least likely to be covered by or to be the beneficiaries of even a minimally adequate private pension.

It is also of critical importance to preserve the automatic cost-of-living adjustments under the Social Security Program. The UAW is vehemently opposed to any freeze or reduction in the Social Security COLA. Cost-of-living increases are part of current law and are counted on by retirees. Tampering with them would represent a real cut in their standard of living, and it would simply help to further undermine confidence in the integrity of Social Security.

The UAW recognizes that Social Security benefits alone fall far short of providing income necessary to maintain a comfortable standard of living for the great majority of Americans. Accordingly, we believe that there is a real need for employer-sponsored private pension plans which can provide retirees with additional pension benefits to help supplement Social Security.

We strongly believe that defined benefit pension plans are the best vehicles for providing a secure and adequate retirement income. These plans have the distinct advantage of making known to future pensioners the amount of income that will be available to them upon retirement.

Moreover, only defined benefit plans possess the flexibility needed to provide essential benefits, including meaningful surviving spouse pensions, early retirement supplements, adequate disability income, and postretirement benefits increases.

On the other hand, defined contribution plans, which are simply used to accumulate amounts in individual accounts belonging to each worker, have a number of drawbacks. The level of funds in any individual's account is a function not only of the level of plan contributions, but also of the plan's investment performance. Due to the variability of investment performance, the luck of the draw frequently determines an employee's retirement income. Furthermore, the accumulated account balance will always be too small to provide an indequate retirement income for the worker who begins participating in the plan late in his or her working career. Most importantly, too often a retiree's accumulated account balance is not actually used to provide retirement income. It is also difficult to provide for postretirement increases in defined contribution plans.

For these reasons, defined contribution plans are less effective than defined benefit plans in assuring retirement income security.

Because employer-sponsored pension plans play a crucial role in providing senior citizens with adequate retirement income, we believe it is entirely appropriate for the Federal Government to use the Tax Code to provide incentives for the growth and development of private pension plans. We are therefore opposed to any proposals to tax earnings on private pension plans. In our judgment, this would simply discourage the growth and development of such plans and would thus have an adverse impact on retirement income security of the elderly.

This does not mean, however, that we favor the unfettered use of tax incentives with respect to private pension plans. For example, we strongly believe that tax preferences should be made contingent upon stringent antidiscrimination rules, which insure that benefits are broadly distributed to all employees, not just a few upper income executives.

We also believe that tax preferences should be granted only to bona fide retirement income programs, which make distributions only for retirement purposes. There is no justification for granting the same type of tax preference to capital accumulation or "savings" vehicles which allow moneys to be used for nonretirement purposes.

The limits on the pension benefits and contributions which are granted favorable tax treatment should also be reduced. There is no reason to subsidize excessive pension benefits or contributions, which simply represents a means of sheltering income from taxation.

The UAW also believes that there is a need for certain reforms to help make the private pension system fairer and more secure. The Pension Benefit Guaranty Corporation must be strengthened by implementing a too-long-delayed premium increase. The single-employee termination insurance program also needs to be reformed, to prevent solvent employers from dumping unfunded pension liabilities onto the PBGC and evading responsibility for nonguaranteed pension benefits.

And reforms are also urgently needed to curb the termination of well-funded plans by employers in order to recapture so-called excess assets, which has recently been jeopardizing the retirement income security of thousands of participants.

The UAW also is committed to reforms which will help to make the private pension system more responsive to the needs of those workers who do not spend all or most of their working careers with one employer. Two steps toward achieving this goal would be to liberalize vesting requirements and to establish a national pension portability program.

Currently, a typical pension plan provides that benefits do not become vested until an employee has been a plan participant for 10 years. We believe this requirement should be lowered to 5 years. This would increase retirement benefits for employees who work for many employers during their working career, or else move in and out of the work force.

But shortening the vesting period is not enough. Workers who satisfy the vesting requirements still will only qualify for a benefit that is fixed in amount when employment is terminated. Their benefits then suffer from steadily eroding purchasing power. More liberal vesting without benefit improvements subsequent to termination would be of rather limited value; although more workers would qualify for benefits, those benefits would be based on frozen amounts for short periods of service.

The establishment of a procedure allowing for the portability of private pension credits is needed in order to provide substantial improvements in retirement security for American workers. Such a reform would recognize the hard economic fact that America has a highly mobile work force.

We recognize the development of such a program will need to address the issue of eligibility, benefit levels, funding mechanisms, and administration. Yet these are not insurmountable tasks. A national private pension portability program could be established in stages. It could develop within industries and later be extended between industries. Another approach would be to require pension portability among employers receiving Government contracts, starting perhaps in the defense industry.

The UAW also supports reform of the rules relating to integration of private pension benefits with Social Security. In addition to being overly complex, the current integration rules permit employers to structure their plans so that benefits flow disproportionately to higher wage earners, while the lower paid employees may receive little or no benefits.

There has also been considerable discussion about how private pension coverage can be extended to additional groups of employees. We believe that the Federal Government can take a number of actions which would help to expand coverage. Most importantly, by adopting and clearly articulating a comprehensive national retirement income policy with simple, uniform, and relatively stable ground rules, the Federal Government can create the type of climate which will encourage employers to establish and maintain private pension plans.

Indeed, the absence of such a national retirement income policy has, in our judgment, been one of the obstacles to the growth and development of the private pension system. Instead of making ad hoc changes in the private pension system every few years that are motivated primarily by budgetary or tax considerations, Congress ought to develop a comprehensive and consistent national retirement policy. We believe this policy should clearly distinguish between the types of tax preferences which are granted to retirement plans, as opposed to capital accumulation vehicles; establish uniform discrimination and distribution rules for all types of pension plans; eliminate unnecessary complexity in the various rules governing retirement plans, especially in the areas of integration and top-heavy rules, and the section 415 limits on contributions and benefits, and preserve the flexibility for employers and unions in their choice of the most appropriate vehicles for providing retirement income to their employees.

We recognize that personal savings also represent one of the three principal sources of retirement income. However, the discretionary income of middle and lower income workers is often so limited as to preclude meaningful personal savings. The opportunity for personal savings is much greater among upper income individuals. Accordingly, individual savings vehicles, such as IRA's, are inherently more discriminatory than employer-sponsored pension plans, and certainly cannot serve as a substitute for broad-based Government programs such as Social Security.

For these reasons, the UAW is troubled by the recent tendency to increase the tax incentives for individual savings vehicles at the expense of Government programs and employer-sponsored plans.

The tax incentives for IRA's are dramatically skewed to the wealthy. There is also substantial evidence that IRA's have simply resulted in a shift of assets from preexisting savings, instead of stimulating increased savings. There is no guarantee that the moneys contributed to IRA's will actually be used for retirement income purposes. And the revenue loss associated with IRA's is large, and growing rapidly.

Finally, we are concerned that in the long run, continued expansion of IRA's will wind up undermining public support for Social Security and the private pension system.

For these reasons, we are adamantly opposed to any further expansion of IRA's. We would support proposals to curb or redirect the tax expenditure for IRA's, including converting the IRA deductions to tax credits and phasing the tax credit out at upper income levels.

At the very least, Congress should offset any contributions made by employees to 401(k) plans against the employees' IRA limits in order to prevent so-called double-dipping.

In conclusion, the UAW appreciates the opportunity to present our views on the subject of the adequacy of the private pension system. We applaud the efforts of this committee in attempting to fashion a national retirement income policy, and we look forward to working with you in the future on these important issues.

Thank you.

Chairman HEINZ. Alan, thank you very much.

[The prepared statement of Mr. Reuther follows:]

PREPARED STATEMENT OF MR. REUTHER

Mr. Chairman, I am Alan V. Reuther, Associate General Counsel for the International Union, United Automobile Aerospace and Agricultural Implement Workers of America (UAW). The UAW appreciates the opportunity to testify before this Committee concerning the adequacy of the private pension system in providing retirement income security to the elderly. This subject is of vital concern to the 1.5 million active and retired members of the UAW and their families, most of whom are covered under negotiated defined benefit pension plans.

The UAW believes that the adequacy of the private pension system cannot be properly judged in isolation. Rather, it is necessary to consider the private pension system in conjunction with the other major mechanisms for providing the elderly with retirement income security—namely, government programs such as Social Security, and individual savings vehicles such as individual retirement accounts

(IRAs). In our judgment, there is a compelling need for Congress to develop and clearly articulate a stable, consistent national retirement income policy that deals with the relationship between these three approaches towards providing the elderly with retirement income security. Too often, it has seemed to us, Congress has made ad hoc changes in the policies governing these three areas, without considering the overall impact on our national retirement income policy. Accordingly, the UAW commends you, Mr. Chairman, and the Members of this Committee, for the leadership which you have displayed in attempting to fashion a comprehensive national retirement income policy. We look forward to working with you in this endeavor in the coming months.

THE ROLE OF SOCIAL SECURITY

Social Security remains the base upon which retirement income security is built. It provides almost universal coverage for the private workforce, has the advantage of complete portability, and is the fairest and most efficient way to provide essential retirement income benefits to our nation's senior citizens. Two-thirds of the over-65 beneficiaries rely on Social Security for more than one-half of their income; a third of this age group rely on Social Security for more than 90% of their income.[1]

In contrast, although the private pension system has grown tremendously in the post-war period, still only about one-third of the population over 65 receives benefits from a private pension plan.[2] Even though more than half of the workers in the private sector are now covered under pension plans, many of them will receive little or no retirement income because of vesting standards and frequent job changes. Thus, the private pension system cannot serve as a substitute for Social Security, which is a comprehensive program designed to meet the needs of the vast majority of workers and retirees.

Since most Americans rely heavily on Social Security, the UAW believes that more emphasis should be placed on making benefits under the program sufficient so that retirees can live in dignity, rather than on the brink of poverty. In particular, we believe that the percentage of pre-retirement income replaced by Social Security must be raised for lower-income workers. These workers have the least resources with which to provide for retirement income security through personal savings. And they are also least likely to be covered by or to be the beneficiaries of even a minimally adequate private pension.

It is also of critical importance to preserve the automatic cost-of-living adjustments (COLAs) under the Social Security program, since they are crucial in providing retirees with protection against inflation. The 1983 Amendments to the Social Security Act permanently cut back COLA for retirees by delaying for six months the effective date for future benefit increases and by changing the measurement formula. This permanent cut in benefits represented a $40 billion savings to Social Security for the remainder of the decade. While we were strongly opposed to this type of change when it was first proposed, we eventually accepted it as part of a bi-partisan compromise which included accelerated payroll taxes, broader coverage of the workforce, and partial taxation of benefits for higher income beneficiaries. These changes were necessary in order to secure the long-term financial health of the Social Security program.

Unlike those changes, the current proposals to freeze Social Security cost-of-living increases (such as the proposal contained in the budget resolution adopted by the Senate for fiscal year 1985) have no such justification. These proposals are simply designed to meet current budgetary needs of the federal government, which are unrelated to the solvency of the Social Security program. Indeed, the 1985 Report of the Social Security Trustees stated that the cash benefit programs are now soundly financed and that "the assests . . . will be sufficient to permit the timely payment of OASDI benefits well into the next century, on the basis of all four sets of assumptions for which estimates are shown."

Accordingly, the UAW is vehemently opposed to any "freeze" or reduction in Social Security cost-of-living adjustments. The cost-of-living increases are part of current law, and are counted on by retirees. Tampering with them would represent a real cut in their standard of living. And it would simply help to further undermine confidence in the integrity of Social Security.

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[1] Robert M. Ball, Fact Sheet #14, Study Group on Social Security.

[2] The Council of Economic Advisors report to the President in February 1985 stated that "about 30 percent of the elderly now receive pension benefits, accounting for about 15 percent of income for all elderly persons."

A national retirement income policy should also focus on various long range improvements in the Social Security system. We believe the financing of the program should be made more equitable. Employers should be taxes on their total payroll, and the maximum taxable wage base for employees should be raised to a level which would reach the total earnings of most high-wage earners. These changes would provide additional Social Security revenues and would lessen the regressive nature of the present payroll tax. Further, we urge Congress to consider a permanent refundable income tax credit to offset a portion of Social Security payroll taxes. Ultimately, we believe that one-third of the cost of the program should be funded with general revenues.

Progressive financing of Social Security, combined with a full employment economy, would make possible several needed improvements in Social Security benefits. The UAW strongly urges Congress to return the age for full benefits to 65, as it was prior to the 1983 Amendments. The increase in the retirement age in the next century is bad social policy because it amounts to a future benefit cut for current workers, and because it will aggravate unemployment for younger workers. This benefit cut will be especially harsh for the majority of early retirees who are forced to retire for health reasons, and for industrial workers and minorities who have not shared in the average longevity increases in our society. The increase in the retirement age was not needed in order to insure the solvency of Social Security. The cost of the cash benefit program is currently about 5% of GNP. Had the retirement age not been changed, the Social Security Trustees estimated that the cost of projected benefits until the middle of the 21st century would have been between 5% and 6% of GNP, a stable and relatively small cost as the baby boom generation moves through the program.

The UAW also supports changes in Social Security benefits which would provide fairer treatment for women who have worked both in the home and in industry. Improvements in the benefit formula for those who have worked many years at substandard wages are needed in order to provide more equitable treatment for underpaid workers, chiefly women and minorities. And changes are also needed in the benefit formula to recognize the reduction of Social Security protection which millions of unemployed workers have suffered.

THE ROLE OF PRIVATE PENSION PLANS

Social Security benefits represent the greatest proportion of retirement income for low and middle income wage earners and a substantial proportion of the retirement income of higher wage earners. However, Social Security benefits alone fall far short of providing the income necessary to maintain a comfortable standard of living for the great majority of retired Americans.

Accordingly, the UAW believes that there is a need for employer-sponsored private pension plans, which can provide retirees with additional pension benefits to help supplement Social Security. We also strongly believe that defined benefit pension plans are the best vehicles for providing, in combination with Social Security benefits, a secure and adequate retirement income. These plans have the distinct advantage of making known to future pensioners the amount of income that will be available to them upon retirement. Another strength of defined benefit plans is that they are covered by the guarantees of the federal government. Moreover, only defined benefit plans possess the flexibility needed to provide essential benefits, including meaningful surviving spouse pensions, early retirement supplements, adequate disability income and post-retirement benefit increases.

On the other hand, defined contribution plans, which are simply used to accumulate amounts in individual accounts belonging to each worker, have a number of drawbacks. The level of funds in any individual's account is a function not only of the level of plan contributions, but also of the plan's investment performance. Due to the variability of investment performance, the luck of the draw frequently determines an employee's retirement income. Furthermore, the accumulated account balance will always be too small to provide an adequate retirement income for the worker who begins participating in the plan late in his or her working career. Most importantly, too often a retiree's accumulated account balance is not actually used to provide retirement income. It is also difficult to provide for post-retirement increases in defined contribution plans. For these reasons, defined contribution plans are less effective than defined benefit plans in assuring retirement income security.

Because employer-sponsored pension plans play a crucial role in providing senior citizens with adequate retirement income, it is entirely appropriate for the federal government to use the tax code to provide incentives for the growth and development of private pension plans. The UAW is therefore vehemently opposed to the various proposals which have been advanced to tax the earnings on private pension plans. The 1984 tax legislation already took a step in this direction, by imposing a tax for the first time on certain "excess" reserves in voluntary employees' beneficiary associations (VEBAs), which are often used to provide retiree health insurance benefits. We urge Congress not to travel any further down this path. In our judgment, the imposition of taxes on private pension plans would discourage the growth and development of such plans, and thus would have an adverse impact on the retirement income security of the elderly.

This does not mean, however, that the UAW favors the unfettered use of tax incentives with respect to private pension plans. For example, we strongly believe that tax preferences for private pension plans should be made contingent upon stringent anti-discrimination rules, which insure that benefits are broadly distributed to all employees, not just a few upper income executives. We also believe that tax preferences should be granted only to bona fide retirement income programs, which make distributions only for retirement purposes. There is no justification for granting the same type of tax preferences to capital accumulation or "savings" vehicles, which allow monies to be used for non-retirement purposes. The limits on the pension benefits and contributions which are granted favorable tax treatment should also be reduced. There is no reason to subsidize excessive pension benefits or contributions, which simply represent a means of sheltering income from taxation, rather than a means of assuring adequate retirement income security.

The UAW also believes that there is a need for certain reforms to help make the private pension system fairer and more secure. The enactment of the Employee Retirement Income Security Act of 1974 was a watershed in the development of the private pension system. The improved participation and vesting standards, increased funding requirements, stronger fiduciary rules, and the pension guarantees provided by the Pension Benefit Guaranty Corporation, were all positive developments. More recently, the passage of the Retirement Equity Act represented a first step towards addressing various inequities faced by women under the private pension system.

But the UAW believes further improvements are still needed. The PBGC must be strengthened by implementing a too-long-delayed premium increase. The single-employer termination insurance program also needs to be reformed, to prevent solvent employers from dumping unfunded pension liabilities onto the PBGC and evading responsibility for non-guaranteed pension benefits. And reforms are urgently needed to curb the termination of well-funded plans by employers in order to recapture so-called "excess assets", which has recently been jeopardizing the retirement income security of thousands of participants.

The UAW also is committed to reforms which will help to make the private pension system more responsive to the needs of those workers who do not spend all or most of their working careers with one employer. Two steps toward achieving this goal would be to liberalize vesting requirements and to establish a national pension portability program.

Currently, a typical pension plan provides that benefits do not become vested until an employee has been a plan participant for ten years. We believe this requirement should be lowered to five years. This would increase retirement benefits for employees who work for many employers during their working career, or else move in and out of the workforce.

But shortening the vesting period is not enough. Workers who satisfy the vesting requirements still will only qualify for a benefit that is fixed in amount when employment is terminated. Their benefits then suffer from steadily eroding purchasing power. More liberal vesting without benefit improvements subsequent to termination would be of rather limited value; although more workers would qualify for benefits, those benefits would be based on frozen amounts for short periods of service. Furthermore, eligibility for other employment related retirement benefits, such as health care and life insurance, are not provided to those only eligible for deferred vested benefits.

The establishment of a procedure allowing for the portability of private pension credits is needed in order to provide substantial improvements of retirement security for American workers. Such a reform would recognize the hard economic fact that America has a highly mobile workforce. It would also take note of the fact that this mobility is increasingly involuntary as workers are exposed to the severe social and economic dislocation triggered by plant closings and runaway shops. These workers are twice penalized—once when they are uprooted by circumstances beyond their control, and then again when they ultimately receive diminished retirement benefits. Carrying pension service from one employer to another can be a workable solution to this problem.

We recognize the development of such a program will need to address the issue of eligibility, benefit levels, funding mechanisms and administration. Yet these are not insurmountable tasks. A national private pension portability program could be established in stages. It could develop within industries and later be extended between industries. Another approach would be to require pension portability among employers receiving government contracts, starting perhaps in the defense industry. Our union has already proposed such a program to several employers in the aerospace industry.

The UAW also supports reform of the rules relating to the "integration" of private pension benefits with Social Security. In addition to being overly complex, the current integration rules permit employers to structure their plans so that benefits flow disproportionately to higher wage-earners, while the lower paid employees may receive little or no benefits. Meaningful reform in this area should seek to assure that pension benefits are more evenly distributed throughout the workforce, and that all workers receive some benefits under a plan.

There has been considerable discussion about how private pension coverage can be extended to additional groups of employees. Concern has often been expressed that the administrative costs associated with establishing and maintaining a pension plan are a significant obstacle to increasing coverage, especially among employers with small numbers of employees. However, there are existing mechanisms which pool administrative functions, thereby providing cost savings and administrative ease. The UAW has had extensive experience with one such plan (the National Industrial Group Pension Plan) since late 1965. Currently, this Plan includes some 800 employer groups nationwide, covering nearly 50,000 people. We believe that this type of plan can provide a partial solution to the "coverage" problem.

In addition, the UAW believes that the federal government can take a number of actions which would help to expand coverage under the private pension system. Most importantly, by adopting and clearly articulating a comprehensive national retirement income policy, with simple, uniform, and relatively stable ground rules, the federal government can create the type of climate which will encourage employers to establish and maintain private pension plans. Indeed, the absence of such a national retirement income policy has, in our judgment, been one of the obstacles to the growth and development of the private pension system. Instead of making *ad hoc* changes in the private pension system every few years that are motivated primarily by budgetary or tax considerations, Congress ought to develop a comprehensive and consistent national retirement income policy. We believe this policy should clearly distinguish between the types of tax preferences which are granted to retirement plans, as opposed to capital accumulation vehicles; establish uniform discrimination and distribution rules for all types of pension plans; eliminate unnecessary complexity in the various rules governing retirement plans (especially in the areas of integration and top-heavy rules and the section 415 limits on contributions and benefits); and preserve the flexibility for employers and unions in their choice of the most appropriate vehicles for providing retirement income to their employees.

The UAW is particularly concerned about the recent proliferation of 401(k) plans for a number of reasons. First, unlike traditional types of retirement income plans, under a 401(k) plan there is no requirement that all employees actually participate in the plan. Typically, employers make matching contributions for those employees who decide to contribute to the plan via salary reduction. Although the plan must meet a "utilization" test, the employer still is not required to make contributions on behalf of all employees, and all employees do not have to participate in the salary reduction program. In our judgment, this represents a bad precedent, and runs counter to efforts to assure greater worker participation under the private pension system. We would therefore support measures to tighten the "utilization" or discrimination rules for 401(k) plans.

Second, the distribution rules for 401(k) plans are much more lax than for other types of retirement income vehicles. As a result, monies contributed to 401(k) plans are often being used for non-retirement purposes; there is an incentive to use these plans as a tax avoidance mechanism, rather than as bona fide retirement vehicles. The UAW therefore supports making the distribution rules for 401(k) plans more restrictive.

Third, to prevent 401(k) plans from being used as a tax avoidance device, the UAW supports lowering the limits on the amounts employees can contribute to such plans via salary reduction. In addition to being more equitable, this would also help to reduce the revenue loss associated with 401(k) plans.

INDIVIDUAL SAVINGS

The UAW recognizes that personal savings represent one of the three principal sources of retirement income. However, the discretionary income of middle and lower income workers is often so limited as to preclude meaningful personal savings. And the opportunity for personal savings is much greater among upper income individuals. Accordingly, individual savings vehicles, such as IRAs, are inherently more discriminatory than employer sponsored pension plans, which must generally meet tough anti-discrimination rules. They certainly cannot serve as a substitute for broad-based government programs, such as Social Security, in providing basic retirement income security for the elderly.

For these reasons, the UAW is troubled by the recent tendency to increase the tax incentives for individual savings vehicles at the expense of government programs and employer sponsored pension plans. Although IRAs were originally conceived as a savings vehicle for persons not covered under employer-sponsored pension plans, they were made universally available as part of the 1981 tax legislation. More recently, the President has proposed that the contribution limits for spousal IRAs be expanded so that individuals can contribute $2,000 to both regular and spousal IRAs.

The UAW is opposed to any further expansion of IRAs. First, the tax incentives for IRAs are dramatically skewed towards the wealthy. In 1982, the highest paid 15% of the working population established 50% of all IRAs.[3] This is hardly surprising, since upper income individuals have more disposable income available for savings, and since the deduction for IRA contributions is worth more to persons in higher tax brackets.

Second, there is substantial evidence that IRAs have simply resulted in a shift of assets from pre-existing savings, instead of stimulating increased savings. Indeed, 54% of all IRA contributions in 1982 came from pre-existing savings.[4]

Third, there is no guarantee that the monies contributed to IRAs will actually be used for retirement income purposes. Because the penalty for early withdrawals is so low, there currently is an incentive for individuals to use IRAs as a tax avoidance, capital accumulation device, and to withdraw their contributions after a relatively short period of time.

Fourth, the revenue loss associated with IRAs is large, and growing rapidly. In 1982, the tax deduction associated with IRAs was $28.4 billion. If the President's proposal were to be adopted, this would result in an additional revenue loss of over $1 billion per year in 1990. A revenue loss of this magnitude simply cannot be justified in these times of record budget deficits.

Fifth, the UAW is concerned that, in the long run, the continued expansion of IRAs will wind up undermining public support for Social Security and the private pension system. In our judgment, these programs represent the best means of providing adequate retirement income security to working men and women.

For these reasons, the UAW adamantly opposes any further expansion of IRAs. In addition, we would support various proposals to curb or redirect the tax expenditure for IRAs, including converting the IRA deduction to a tax credit and phasing the tax credit out at upper income levels. At the very least, Congress should offset any contributions made by employees to 401(k) plans against the employees' IRA limits, in order to prevent "double dipping". Finally, in order to encourage the use of IRA contributions for retirement income purposes, we would support increasing the penalty on premature withdrawals to 20 percent.

THE TREATMENT OF RETIREMENT SAVINGS UNDER THE PRESIDENTS TAX REFORM PROPOSAL

President Reagan's tax reform package contains a number of positive proposals relating to the tax treatment of retirement savings. In particular, the proposals to apply uniform distribution rules to all types of retirement savings plans, to simplify the rules governing the limits on pension contributions and benefits, and to insure that funds contributed to retirement plans are actually used for retirement purposes by imposing a stiff excise tax on premature distributions, are all steps in the right direction. In addition, the UAW welcomes the various reforms that have been proposed by the President with respect to 401(k) plans, including lowering to $8,000 the limit on discretionary employee contributions, tightening the distribution rules which are applicable to these plans to encourage the retention of monies for retire-

[3] Employee Benefit Research Institute, Issue Brief #32, July, 1984.
[4] Ibid.

ment purposes, tightening the discrimination-utilization tests under these plans, and offsetting the allowable contributions to IRAs and 401(k) plans. The UAW also strongly supports the proposals to repeal 10 year income averaging and capital gains treatment for lump sum distributions, as well as the provisions which would encourage direct ownership of ESOPs by employees.

The UAW is concerned, however, that the President's plan also contains proposals with respect to retirement savings that could have an adverse impact on the continued growth and development of retirement plans. For example, we are concerned that the proposed rules relating to the imposition of an excise tax on premature distributions from retirement plans in structured in a manner that could interfere with the operation of bona fide early retirement programs. Similarly, the proposal to place an excise tax on the reversion of excess assets to employers upon the termination of a defined benefit pension plan could have a deleterious impact on the funding of such plans, without providing any meaningful remedy for the numerous abuses which have arisen in connection with termination-reversions. The proposal to allow expiration of the tax credit for employer contributions to an ESOP also seems to us to be unwise. This tax credit serves the dual purpose of promoting employee ownership of their employer's stock and enabling workers to supplement their retirement income.

Most importantly, the UAW is strongly opposed to the President's proposal to increase the limits on tax deductible contributions to "spousal IRAs" from $250 to $2,000. As previously indicated, we oppose any further expansion of IRAs for a number of reasons. The Administration has tried to justify this proposal as being a "pro-family" measure which will help homemakers. But it will actually contribute little or nothing to the retirement income security of most homemakers. The available data clearly demonstrates that the wealthy participate in IRAs to a much greater extent than middle and lower income persons. Raising the limit on tax deductible contributions to spousal IRAs will simply aggravate this situation since, for the most part, only higher-income families will have sufficient disposable income to be able to contribute the extra $1,750 to a spousal IRA.

As the debate on President Reagan's tax reform plan proceeds, the UAW hopes that the various proposals relating to retirement savings will not be examined solely from the perspective of tax policy, but also in terms of the broader social policy issues associated with insuring that the elderly are provided with adequate retirement income. In our judgment, this is an opportunity for Congress to develop and articulate a comprehensive national retirement income policy. We stand ready to work with you, Mr. Chairman, and the Members of this Committee in this task.

CONCLUSION

The UAW appreciates the opportunity to present our views on the subject of the adequacy of the private pension system. We applaud the efforts of this Committee in attempting to fashion a national retirement income policy, and we look forward to working with you in the future on these important issues.

Chairman HEINZ. Jack Sheehan.

STATEMENT OF JOHN J. SHEEHAN, WASHINGTON, DC, LEGISLATIVE DIRECTOR, UNITED STEELWORKERS OF AMERICA

Mr. SHEEHAN. Thank you, Mr. Chairman.

My name is Jack Sheehan, with United Steelworkers of America, and I have been with them, unfortunately, for many more years than you mentioned.

In terms of an overall view, we are certainly in these hearings revisiting the political and legislative compromises and accommodations we made in 1974 to get the ERISA bill passed. I think in a way, it may be somewhat painful to do that, yet necessary, but I think it should not be done at the risk of downgrading the enormous achievement of the passage of the 1974 act in the midst of those political situations that were there, and in spite of the legislative compromise made in order to get the bill passed. I must say from my own view, I certainly congratulate you for wanting to open up some of those accommodations that were made.

The Steelworkers, on behalf of its members is pleased to have this opportunity to testify before your committee. Our Union has long believed that all members of our society—and not just the organized sector—are entitled to enjoy a retirement of equity, of dignity and of financial security, and that is is the role of government through Social Security and Medicare, and actually, to the private sector, through the employer-sponsored plans, to provide this retirement income security.

We take pride in recognizing that there are hundreds of thousands of retired Steelworkers and their families who are financially secure in retirement in large part because their union has been successful over the years at the bargaining table.

The topic today—"Pension Gamble: Who Wins? Who Loses?"—is a timely one, for it is more and more apparent that whether a particular individual receives all or even part of his or her pension benefit, is very frequently in large part a matter of chance.

The Steelworkers have most directly experienced this pension gamble in recent years, in the context of the economic depression, which has and continues to ravage industrial America. You are quite right in making some reference to the steel industry. Little did we think in 1974, the Steelworkers Union would be one of the prime beneficiaries of this pension plan, and certainly your role, Mr. Chairman, in trying to arrest the damages in the steel industry should be noted by me, certainly, publicly.

Plant shutdowns are frequently accompanied by the termination of severely underfunded pension plans. Although the Pension Benefit Guaranty Corporation and its single-employer termination insurance program guarantee substantial amounts of pension benefits upon the termination of unfunded plans, these guarantees are far from complete. The result has been the loss by thousands of victims of plant shutdowns of all or a substantial part of their vested pension benefits.

The pension gamble is also evident in the pension coverage and in the vesting statistics. The Employee Benefit Research Institute, which testified a little while ago, estimated that in 1983, only 56 percent of all nonagricultural wage and salary workers were covered by the private sector of public sector pension plans. Thus, an employee stands only slightly better than one in two chances of being covered in a pension plan. Of that group, only 33 percent were vested in their pension benefits.

Hence, one's likelihood of being both covered in a plan and being vested in the plan are only one in three. It is also clear that your chances of being vested in your pension are directly related to your income.

The EBRI estimates, for example, that only 3.5 percent of the employees who earn less than $5,000 annually are vested, but 68.5 percent who earn over $50,000 or more annually are vested in their pension benefits.

We all agree that this pension gamble must be reduced and eventually eliminated, if our national goal of retirement income security for all workers is to be realized.

The answers, we suggest, are not as difficult as some might expect. We indicate in the testimony a couple of examples.

First of all, Mr. Chairman, Congress should act promptly to substantially increase the annual per capita premium of the PBGC's single-employer termination insurance program to permit this vital program to remain financed on a sound basis. If the single-employer termination insurance program is not kept sound, the pension gamble will increase substantially as employees will face an even greater risk that their pensions, although vested, may not get paid if the employer is no longer profitable or solvent when the employee finally retires.

I might mention also on the side, Mr. Chairman, that the increase of the premium is part of the budget resolution on the House side. I know you are very much involved with this aspect of the pension issue. It is our hope that we can get the premium issue resolved aside from what we might be doing with overall amendments to the Original Pension Protection Act.

Second, we firmly believe that minimum vesting requirements should be shortened. The union, supports the 5-year vesting.

I might note, Mr. Chairman, that before 1974, many unions, including our own, had vesting requirements much less liberal than the law required. For instance, the Steelworkers had a vesting requirement after 15 years of service with an age requirement. We are now down to the 10, and certainly would recommend legislation that would move to the 5.

Third, we believe that portability between plans should be encouraged. And without elaborating on that, the collapsing of plans, the termination of plans, the mobility of people certainly now means we ought to revisit this issue, which was avoided in 1974 with regard to portability.

Fourth—and I support Alan's comments on the IRA's. Our union does not share the view of some that the answer to the pension gamble is the individual retirement account. We are sharply critical of the availability of IRA's to all persons with earned income, regardless of whether they are covered under qualified pension plans and regardless of their total income. We are likewise sharply critical of proposals to expand the IRA contribution limit. We are critical of IRA's because they are unquestionably unfair. Though almost everyone has the opportunity to establish an IRA, it is clear that only the upper-middleclass and the wealthy, in fact, take advantage of this tax subsidy to any significant degree.

In fact, Mr. Chairman, we look upon the IRA's as a pressure on negotiated pension plans, and actually as a pressure on expanding the Social Security system.

Recently, the National Journal in an article on pension security, indicated that,

> The Internal Revenue Service said that 13 million tax returns in 1983 included claims for IRA tax deductions. The Social Security Administration reported that in 1982, about 36 million persons were receiving old age survivor or disability insurance through the payroll-financed Social Security.

Now, the article quotes from an official of the Heritage Foundation in this manner. The foundation noted the relationship between 13 million on IRA's and 36 million in Social Security:

> You are going to get to a point where you have a political mass of IRA account-holders that is roughly equal to the political mass of Social Security, he said, which

will reduce the political clout of congressional champions of ever-higher Social Security benefits.

So this issue on the IRA, Mr. Chairman, is indeed very serious. I would like to close at this point and say that we are encouraged by your review of this issue of pension improvements, and certainly would urge you to move forward, and we would pledge our support to you on it.

[The prepared statement of James Sheehan follows:]

PREPARED STATEMENT OF MR. SHEEHAN

The United Steelworkers of America, on behalf of its members is pleased to have this opportunity today to testify before the Aging Committee. Our union has long believed that all members of our society are entitled to enjoy a retirement of dignity and financial security and that it is the role of the government through Social Security and Medicare and the private sector through employer-sponsored pension plans to provide this retirement income security.

We take pride in recognizing that there are hundreds of thousands of retired Steelworkers and their families who are financially secure in retirement in large part because their Union has been successful over the years at the bargaining table.

The topic of today's hearing—"The Pension Gamble: Who Wins, Who Loses"—is a timely one, for it is more and more apparent that whether a particular individual ever receives all or even part of his or her pension benefit is very frequently in large part a matter of chance.

Our Union and its members have most directly experienced this "pension gamble" in recent years in the context of the economic depression which has and continues to ravage industrial America. Plant shutdowns are frequently accompanied by the termination of severely underfunded pension plans. Although the Pension Benefit Guaranty Corporation and its single employer termination insurance program guarantee substantial amounts of pension benefits upon the termination of underfunded plans, these guarantees are far from complete. The result has been the loss by thousands of victims of plant shutdowns of substantial parts of their vested pension benefits.

The "pension gamble" is also evident in the pension coverage and vesting statistics. The Employee Benefit Research Institute estimates that in 1983 only 56% of all non-agricultural wage and salary workers were covered by private sector or public sector pension plans. Thus, an employee stands only slightly better than a one in two chance of being covered in a pension plan. Only 33% of all non-agricultural wage and salary employees are vested in their pension benefits. Hence, one's likelihood of both being covered in a pension plan and being vested in the plan are only one in three. It is also clear that your chances of being vested in your pension are directly related to your income. The EBRI estimates, for example, that only 3.5% of employees who earn less than $5,000 annually are vested, but that 68.5% of employees who earn $50,000 or more annually are vested in their pension benefits.

We all agree that this "pension gamble" must be reduced and eventually eliminated if our national goal of retirement income security for all workers is to be realized.

The answers, we suggest, are not as difficult as one might expect:

1. Congress should act promptly to substantially increase the annual per capita premium of the PBGC's single employer termination insurance program to permit this vital program to be financed on a sound basis. If the single employer termination insurance program is not kept sound, the "pension gamble" will increase substantially, as employees will face an even greater risk that their pensions, although vested, may not get paid if the employer is no longer profitable or solvent when the employee finally retires.

2. We firmly believe that minimum vesting requirements should be shortened. Most of the pension plans which cover our members provide for full vesting after 10 years of service and no vesting prior to an employee's attainment of 10 years of service. A great many employees, through no fault of their own, fail to accumulate 10 years of service with the same employer and may spend their entire adult lives working and yet never acquire a vested pension. Workers, in general, are more mobile and are less likely than ever to remain with a single employer for long periods of time. It is fundamentally unfair to deny a worker the benefit of contributions made on his behalf to his pension plan by his employer solely because the employee, because of layoff, shutdown, or simply better opportunity elsewhere, fails to remain

in the plan for 10 years or longer. A 5-year vesting requirement would appear to be a reasonable compromise between an employee's right to ultimately receive pension contributions made on his behalf and the employer's interest in encouraging loyalty and keeping its paperwork burdens to a minimum.

3. We believe that portability between plans should be encouraged. Whether or not an employee is vested in a pension, the employee should be able to transfer his pension credits and the assets relating to those credits to another pension plan when that employee changes jobs. Pension benefits are earned by an employee and "belong" to that employee; he should, within reason, be able to take those benefits with him when he changes jobs. By so doing, the employee no longer has to gamble that his former employer will be ready, able and willing to pay him his pension when he finally retires.

4. Our Union does not share the view of some that the answer to the "pension gamble" is the individual retirement account. We are sharply critical of the availability of IRA's to all persons with earned income, regardless of whether they are covered under qualified pension plans and regardless of their total income. We are likewise sharply critical of proposals to expand the IRA contribution limit. We are critical of IRA's because they are unquestionably unfair. Though almost everyone has the opportunity to establish an IRA, it is clear that only the upper middle class and the wealthy, in fact, take advantage of this tax subsidy to any significant degree.

In an era of severe budget deficits in which vital social programs are being curtailed or eliminated, why should a tax shelter which disproportionately benefits the well-to-do and causes a huge annual loss of revenue to the Federal government be preserved, much less expanded? If more personal saving is the goal, then it should be accomplished in a way that does not discriminate in favor of the wealthy. If capital accumulation is the goal, then it, too, should be accomplished in a non-discriminatory manner. If faster vesting in retirement benefits is desired, then ERISA should require faster vesting for pension plans. If portability is desired, then the law should require that pension benefits be portable.

In conclusion, the United Steelworkers of America supports the Committee's efforts to draw attention to the reality that pension benefits represent a gamble that working men and women can ill-afford to take. We note that Congress, in enacting ERISA, declared it to be the policy of ERISA "to protect . . . the interests of participants in private pension plans and their beneficiaries by improving the equitable character . . . of such plans." In enacting ERISA, Congress moved a long way towards that goal. Too much, however, is still left to chance.

Chairman HEINZ. Jack, thank you.

I just want you to know that, speaking for myself—and I think, frankly, for all the members of this committee—that we are mindful of the commitment to Social Security that the Congress has made and needs to retain. Whether it is IRA's or anything else, I do not think we are going to let any developments undermine that.

You have all been excellent witnesses. I do have some questions for you.

Let me start with Harry Smith. I suspect his retirement security will be reasonable—if you get any surprises when you retire, Mr. Smith, we are all in trouble.

Having celebrated the 10th anniversary of ERISA last September, it is important to recognize, notwithstanding all the problems that we have learned about over the last 10 years, that the system, as Jack Sheehan at the outset indicated, really has performed a lot better than the old system, and that indeed, there are people out there such as the Sun Co. that are doing as good a job as I have ever seen in finding that mix of retirement security and freedom of choice through savings plan, where workers can take withdrawals in a savings plan, but cannot take withdrawals, as I understand the way your plan operates, from their basic retirement benefits plan.

Mr. SMITH. Yes.

Chairman HEINZ. You talk about the need to improve benefits to mobile workers without compromising benefit adequacy. You have clearly given a lot of thought to this, could you give us some idea of what features a pension plan should have to accomplish those goals?

Mr. SMITH. We think that younger employees who work for, say, 7, 8, 9, or 10 years, and want to go to another company, that at this point enter defined benefits plans, the accrual formula is low, and the amount of money they would have available, even if vested—you have to have more than 10 years in our pension plan—incidentally, in the capital accumulation savings plan, the vesting is immediate, and it is 100 percent, and this helps—but the problem, then, if the employee wants to go to another company, and he leaves with just the defined benefits, even though vested, that amont of money is very, very low. And we have the $1,750 lump-sum payout, and there is certainly a good bit of that. But we are concerned that the employee is just not getting a square deal. So, one of the alternatives we are looking at right now, frankly, is the defined contribution plan, so that the accruals—to us, the defined contribution plan, is more expensive than the plan benefits—and the accruals would be greater, he would have a bigger sum of money to take with him, and it would be our hope that, whether or not Congress makes it mandatory, that he or she would put the money in rollover plan of some sort to save it for retirement. But this at the moment is the only thing we have come up with, a defined contribution-type plan——

Chairman HEINZ. With a rollover into some kind of retirement savings.

Mr. SMITH. Yes. We are quite firm on that. We just do not—you see, in the simplest terms, a pension benefit is a deferred wage, and a business, in our view, has to make enough money—they can pay me $10 an hour and put $1 in pension plan, and do that, so when I retire, I have adequacy. And somehow or other, the way the accruals work on the defined benefit type, you are just not giving the employee his due. So in other words, you could either step up the accruals and have lump-sum payouts of the defined benefits—I do not like that. So we are now looking at defined contribution.

Chairman HEINZ. Let me go on to one of the other major issues we have touched on many times, and you mentioned it in your statement, as have Mr. Reuther and Mr. Sheehan—namely, that of integration with Social Security.

We have heard some sharp criticism of integration today, yet you, at Sun—and you are a very progressive employer, in my judgment—you do integrate your pension plan with Social Security.

Mr. SMITH. Yes.

Chairman HEINZ. Can you explain to us why Sun integrates its plans, and do you have employees who are either largely or totally integrated out of the plan, as our first witness was?

Mr. SMITH. Not very often. The petroleum industry is paid a little bit higher than J.C. Penney, and we do not have that problem.

Chairman HEINZ. It would not be hard, I guess.

Mr. SMITH. But we believe in integration, because it is an economic matter. There is a large amount of money that the employer pays into the system, and a large amount of money the employee pays into the system. So we have half offset at the maximum.

On the other hand, we would not cry about it if it were mandated, or if the unions were successful in saying, "Hey, we are tired of this integration. That is our money, and let's do something about it." We would do it. But what we would do is this. Our goals are income replacement goals. With the higher paid people, Alan, we don't like them so well—we give them 50 to 55 percent——

Chairman HEINZ. The Autoworkers are not so badly paid from time to time. Of course, to be fair to Alan, he is not a member of the United Autoworkers, as I understand it.

Mr. SMITH. I see.

Chairman HEINZ. Mr. Sheehan, are you a member of the Steelworkers.

Mr. SHEEHAN. Yes, sir.

Mr. SMITH. The income replacement goals for higher paid people are 50 to 55 percent of their final 3; for lower paid people, 65 to 75 percent—at 30 years of service, you see.

And so if we stick to our income replacement goals, and we get down to the numbers, it does not make any difference whether they are integrated or not. But the reason we have done it is it is just a neat system. It is tidy, it is easy to handle. But the world would not come to an end if you stopped it.

Chairman HEINZ. So you think that we could limit the integration without doing terrible violence to——

Mr. SMITH. It would be difficult, because the plans would have to be renegotiated. You would have to pull down the benefits from the private plan, because these benefits would go up if integration were eliminated. So if you kept the same income replacement goals, then you would redesign all the plans of the country that are integrated.

Chairman HEINZ. Let me ask Alan Reuther. Alan, you mentioned that the National Industrial Group Pension Plan is an example of an approach that can help solve the coverage problem. How does that plan work, and why do you think it might interest small plans in offering pensions?

Mr. REUTHER. That plan is a multiemployer plan, and we found it to be useful for smaller employers. What it basically does is to pool the administrative costs. It is basically a standardized plan, and a small employer can go into it, knowing that their only obligation would be a certain defined cents-per-hour contribution. But the plan will, then, provide certain defined benefits to the covered employees.

Chairman HEINZ. Earlier, Mr. Smith said he wanted to say something about the administration of pension plans.

Mr. SMITH. Yes. I have heard so many stories, you know, it really upsets me. The way we operate at Sun—I do not know whether it is good or bad, but it works—the plan administrator reports to the board of directors through the compensation committee. He does not report to a boss in the company. The compensation committee of the board is made up of four or five outside directors, so they are free of pressures. And we have, I think, a really outstanding claims procedure—there is another name for it under the law, whatever it is—so if anybody out in the backlands anywhere has a problem, they just pick up the phone and call, and these things are looked into. This lady who had 9½ years service, I think she got rooked. And even if she did not, I know what Sun would have done. The plan administrator would have told somebody in the line of management, "If you don't have a job, if you have to lay her off, put her on unpaid leave of absence until she gets 10 years, and give her her pension."

I think the administration of these plans can be beefed up, and I view the plan administrator as being responsible to participants rather than to the company.

Chairman HEINZ. The way you have it structured, you do not have a bunch of "managers" sitting over you, for example, who are worried constantly about how much black ink or how little red ink there is going to be month-to-month, week-to-week, year-to-year.

Mr. SMITH. Yes. Our plan actually says, Senator, that the plan administrator's decision is final and binding to all parties.

Chairman HEINZ. You are a czar.

Jack Sheehan, you testified with some eloquence to the need for expanded coverage and greater portability of benefits. You also had a minimum of strong endorsement of the individual retirement account in your statement.

The IRA was originally set up to broaden coverage and provide portability, but clearly, you do not support an expansion of IRA's to achieve those goals.

Now, it is a little hard to see from here, but that chart on the right shows that the way you get coverage is to be in a big company or to be in a union, and preferably in a union in a big company. If you are in a small company or in a nonunion job, or both, you really have some difficulties of ever getting into a pension plan.

Given that reality and excluding the message for all small companies to become large and unionized by the United Steelworkers and the United Autoworkers—something you might like, but not something that we should plan government policy on—what approaches do you think might make sense to encourage expanded coverage and better portability?

Mr. SHEEHAN. I guess we ought to exclude one other item, and that is making the steel industry small companies, too, as seems to be occurring here.

The IRA apparently was introduced with the idea of helping those that do not have pension coverage. The pursuit of that objective, namely to get someone who does not have coverage into a plan, has to be investigated.

The peculiar circumstance is the fact that the IRA's are available legally to everybody but from a practical point of view, they are available only to those with higher income. Chances are, those of higher income are either in large companies or, if you wish, in organized sectors of labor. So therefore, the use of the IRA to spread pension protection among the noncovered plans does not meet that goal or objective.

Chairman HEINZ. Are you urging in a sense that IRA's be integrated with pension plans in the way pensions are integrated with Social Security?

Mr. SHEEHAN. As Alan was indicating, I think, instead of integration, I guess we are asking for an eventual phaseout of that as a tax break. It is a tax loophole to those with higher incomes.

Chairman HEINZ. When you say you want to phase it out as a tax break, you do not mean you want to end all IRA's—or, do you?

Mr. SHEEHAN. Well, if hard pressed at this moment, I would think that might be the ultimate conclusion that you probably cannot eliminate it unless you do it across-the-board.

But I think that the reason for the IRA, one of the reasons for the IRA, and I take it on good faith, was to spread pension protection among the group that is on your chart, low-income and small firms. That goal is not being reached. So therefore, from that point of view, IRA's should be completely abandoned.

I am disturbed by what I read to you from the National Journal, that it might mean that there is another kind of an agenda on the way; and second, Mr. Chairman, this whole issue that one has got to go it alone, take care of oneself—we have these negotiated or otherwise employer-employee pension plans—they are group plans. The IRA is a direct attack on that. The IRA says: "You take care of yourself. If you can't, sorry, fellow."

To a large extent, I am afraid the IRA may induce this "me-too" society, just me and nobody else.

Chairman HEINZ. But it strikes me that it does not have to be all or nothing. Let's grant your concerns and your fears. It seems to me that one way of maximizing one of the original intents of IRA's, which is to create more pension retirement security for workers in noncovered areas would, in effect, be to have some kind of integration of IRA's with pension plans, where the bigger your pension plan, the less IRA you could have, down to none at some point. That would, in effect, limit IRA's to people who really needed them. What the definition of "need" is for what income level, pension level, I suppose we can debate endlessly, but conceptually, why wouldn't that be at least a major step in the right direction?

Mr. SHEEHAN. Let me make a quick response, because I saw Alan wave his hand, too. I would say that right away, you can see the influence on the collective bargaining agreement. The employer can say, "Look, don't worry about it. If we don't give you a good pension in negotiations—indeed, we are so hard-pressed and should not be committing our funds, which we need it for modernization or capital investment—you should take your money and invest in an IRA". Thus you will get a downturn in the negotiated pension plans, the employer/employee plans which up until now have been providing these services to at least 56 percent of the workers of the country.

The IRA will eventually erode that. It will take that opportunity away just like there may be an attack on the whole Social Security System. Some people say, "Why can't I take my money and put it away? It is better than Social Security."

Well, we will build up a massive delusion with people in this country, and when the bubble bursts, they will be flat out, with no Social Security and with no pension plans.

Chairman HEINZ. Mr. Smith?

Mr. SMITH. Yes. I just want to comment to Jack that since so many of the American workers are not in big business, not in big industries, that there really is a place for IRA's, if there could be more controls. For example, as a matter of public policy, I do not really think that a person, say, who is enrolled in a 401(k) should really have an IRA. I think enough is enough, you know, if you know what I mean—certain controls like that.

But there really is a large place for a large number of people in some kind of a plan.

Mr. SHEEHAN. Just to correct myself a couple of times. I did not mean to say "union-negotiated pension plans", but I did mean to say "employer-employee pension plans" but negotiated—

Chairman HEINZ. Yes. Alan, you had a point.

Mr. REUTHER. The suggestion you were making about integrating private pension coverage versus IRA is really the situation we had prior to 1981, when the only people who could establish IRA's were those who were not covered. Congress wanted to revert to the pre-1981 situation——

Chairman HEINZ. That was a little simpler version of integration than I would take "integration" to mean, because it was either all or nothing. If you had any pension plan, no IRA's, no matter how lousy the pension plan.

Mr. REUTHER. Perhaps another approach would be—for example, one of the proposals that is contained in the President's tax plan is to offset the 401(k) and IRA contribution. We are supportive of that.

Chairman HEINZ. Mr. Smith has said that that makes sense to him, too.

Very well, gentlemen, you have been outstanding, as usual.

Jack do you have one last point you would like to make?

Mr. SHEEHAN. Yes, if I could just make one other comment for the record. With regard to revisiting some of the 1974 act, there is one item I would like to make reference to. The PBGC guarantees a basic benefit, and it does not guarantee——

Chairman HEINZ. Let me hold you on the point for a second. We have steered away from that particular issue, not out of lack of interest on my part, but that will be an issue which the Senate Finance Committee and its distinguished subcommittee chairman of Pensions, Savings and Investment, who also happens to be the chairman of the Aging Committee, will have ample opportunity to take testimony on. It is an issue which the Finance Committee must address, and soon.

Mr. SHEEHAN. OK. Well, I am going to be pleased to meet that chairman——

Chairman HEINZ. So you will be back.

Mr. SHEEHAN [continuing]. And we will be back, because when we are ending up with a lot of terminated companies and plants, early retirement for a permanently severed worker is an important pension protection that is needed.

Chairman HEINZ. Jack, I understand the need, the problem, and I am inclined to agree with you.

Thank you all very much. We appreciate your being such good witnesses.

We are adjourned.

[Whereupon, at 12:05 p.m., the committee was adjourned.]

APPENDIX

MATERIAL RELATED TO HEARING

ITEM 1

BRIEFING PAPER
HEARING ON "THE PENSION GAMBLE: WHO WINS? WHO LOSES?"
BEFORE THE U. S. SENATE SPECIAL COMMITTEE ON AGING
JUNE 14, 1985

INTRODUCTION

Although pension funds are a major part of the U.S. economy and account for a large portion of Federal tax expenditures, pension benefits today provide a relatively small portion of the total income received by the elderly. While there are more pensioners among currently retiring workers than there have been in previous generations, this trend is not likely to continue. Many features of the pension system now combine to prevent workers from earning pension benefits. Absent legislation there is little chance of these features changing in the future.

Workers who fail to earn pension benefits on a job fail for one of three reasons: 1) they are not covered by a pension plan on their job, 2) they are covered but lose benefits because they change jobs, or 3) they are covered but do not earn a benefit because the pension is integrated with Social Security.

These shortcomings of the pension system redistribute pension and tax benefits from uncovered workers, mobile workers, and low-earners to the pension-covered career employee with moderate to high earnings. Lack of coverage and redistribution of benefits limits the contribution the pension system can make to the adequacy of retirement income. It also raises questions of fairness and equity in the tax system which encourages pension plans.

I. BACKGROUND

What are pension plans?

Pension plans are sponsored by employers or unions to provide employees retirement benefits to supplement Social Security. Most pension plans are sponsored by a single employer and provide employees credit only for service performed for the sponsoring employer. When employees change jobs they cease accumulating credits in the old plan and must begin anew in the next employer's plan.

How widespread are pension plans?

Today there are over 800,000 private-sector plans with over 40 million private wage and salary workers participating; and another 6,600 public-sector plans with 16 million Federal, State and local government employees participating.

Just over half (52 percent) of the private wage and salary workers were covered by an employer-sponsored pension plan in 1983.

As of 1984, private pension funds totaled $700 billion and accounted for 42 percent of the institutional assets in the economy. The Federal Government encourages employers to offer pensions by granting them favorable tax treatment. In 1984, Federal tax expenditures for public and private pensions cost the Government $44 billion.

How are pension benefits determined?

The amount of the benefit paid by a plan is a function of the employee's pay and length of service under the plan.

Defined benefit plans specify the benefit the plan will pay to retirees, leaving the employer responsible for making sufficient contributions over the workers' careers to fund the benefits. For example, a typical defined benefit plan may promise to pay a worker reaching normal retirement age (65) a benefit equal to:

(1.5% of "final average pay") X (years of service under the plan).

In this example, an employee with 20 years of service would earn a benefit equal to 30 percent of his or her final pay.

Defined contribution plans specify the annual contributions made on behalf of employees, with an individual's benefit amount dependent upon the investment performance of his or her own account. For example, a defined contribution plan might promise to contribute for each employee each year an amount equal to 10 percent of the employee's pay. The amount of benefit this will provide the employee at retirement cannot be specified.

What is the Federal role in the pension system?

Private pensions are provided voluntarily by employers. Nonetheless, the Congress has always required that pension trusts receiving favorable tax treatment benefit all participants without discriminating in favor of the highly-paid.

Pension trusts receive favorable tax treatment in three ways: 1) employers deduct their contributions currently even though they are not immediate compensation for employees, 2) income is earned by the trust tax-free, 3) employer contributions and trust earnings are not taxable to the employee until received as a benefit. The major tax advantage, however, is the tax-free accumulation of trust interest ("inside build-up") and the fact that the tax on benefits is usually at a lower rate than it would have been if levied on the contributions when made.

In the last decade the Congress has increasingly used the special tax treatment as leverage to enforce widespread coverage and benefit receipt. In the Employee Retirement Income Security Act (ERISA) of 1974, Congress first established minimum standards for pension plans to ensure a broad distribution of benefits and limit pension benefits for the highly-paid. ERISA also established standards for funding and administering pension trusts, and added an employer-financed program of Federal guarantees for pension benefits promised by private employers.

In 1982, Congress sought, in the Tax Equity and Fiscal Responsibilty Act (TEFRA) to prevent the fact of discrimination in small corporations by requiring so-called "top heavy" plans to accelerate vesting and provide a minimum benefit for short-service workers.

In 1984, Congress enacted the Retirement Equity Act (REA) to improve the delivery of pension benefits to workers and their spouses. REA lowered minimum ages for participation to 21, provided survivor benefits to spouses of vested workers, and clarified the division of benefits in a divorce.

II. ISSUES

1. ADEQUACY OF BENEFITS

What is an "adequate" retirement benefit?

The goal of retirement plans is to replace a worker's pre-retirement earnings with sufficient benefits to maintain his or her standard of living into retirement. The President's Commission on Pension Policy recommended in 1981 that to achieve this goal, the worker earning the average wage would need income from pensions, Social Security, and other sources equal 60 to 75 percent of pre-retirement earnings.

The President's Commission also recommended that "replacement ratios" for low wage earners should be higher (75 to 90 percent) and for high wage earners should be lower (45 to 60 percent) than those for the average wage earners (see Chart 1). The replacement ratio needed to maintain a reasonable standard of living declines with higher earnings because it is thought that the highly-paid can live with less more easily than the low-paid who already consume only necessities.

What role should pensions play?

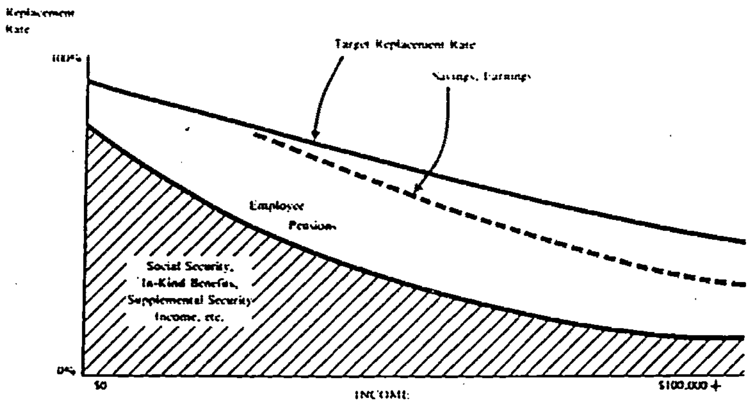
Pensions are usually intended to add benefits to Social Security to bring workers' retirement incomes up to an adequate level of income replacement. Because Social Security provides a higher replacement to low earnings workers (54 percent) than it provides to middle-earnings workers (25 percent), pensions often "tilt" their benefits the other way - providing a higher replacement to the higher paid. For example, a minimum wage worker receiving 54 percent of pre-retirement earnings from Social Security would only need to replace 20 to 35 percent of pre-retirement earnings from a pension to meet the Pension Commission's goal of 75 to 90 percent replacement. On the other hand, a worker at the Social Security taxable maximum would need to replace 35 to 50 percent or pre-retirement earnings from a pension.

How much income do pensions provide now?

Older Americans today get relatively little income from pensions. Three-fourths of those 65 and older receive no pension benefits. Only 14 percent of the income the elderly receive in total comes from pensions - 7 percent from private pensions and 7 percent from public pensions (see Chart 2).

The generation of workers retiring today are benefiting somewhat more from the pension system than previous retirees. Nearly half of the families who retired on Social Security in 1980 and 1981 are receiving some income from pensions, although one-half of these receive less than $400 a month in benefits from all their pensions combined.

CHART 1
THE RELATIVE ROLES OF RETIREMENT INCOME SOURCES



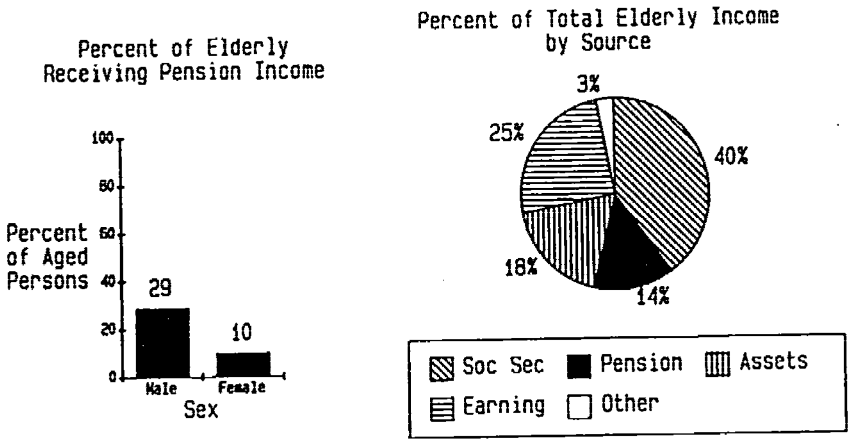
* This chart illustrates the hypothetical, relative roles of the various retirement income sources that the Commission is trying to achieve in its recommendations. The chart is not intended to indicate a precise relationship between the various components.

Source: President's Commission on Pension Policy

What is an adequate retirement income? The President's Commission on Pension Policy recommended in 1981 that an adequate retirement income for a worker earning the average wage should be 60 to 75 percent of pre-retirement earnings. Workers with lower earnings would need a higher replacment since necessities consume a larger share of their income. Workers with high earnings would need a lower replacement.

Social Security provides most of the income replacement needed by the lower-paid. Pensions are designed to provide greater supplementation at higher earnings levels as the role of Social Security diminishes.

CHART 2
THE ROLE OF PENSIONS IN PROVIDING INCOME TO THE ELDERLY
1982



Source: Social Security Administration. Income of the Population 55 and Over, 1982 (Washington, D.C.: GPO) March, 1984.

Older Americans today depend primarily on Social Security for income in retirement. Pensions continue to play a relatively minor role. Only one in four older Americans currently receives income from a private or public employer-sponsored pension. Pensions also provide only 14 percent of the total income the elderly receive -- 7 percent comes from private pensions and 7 percent from public pensions.

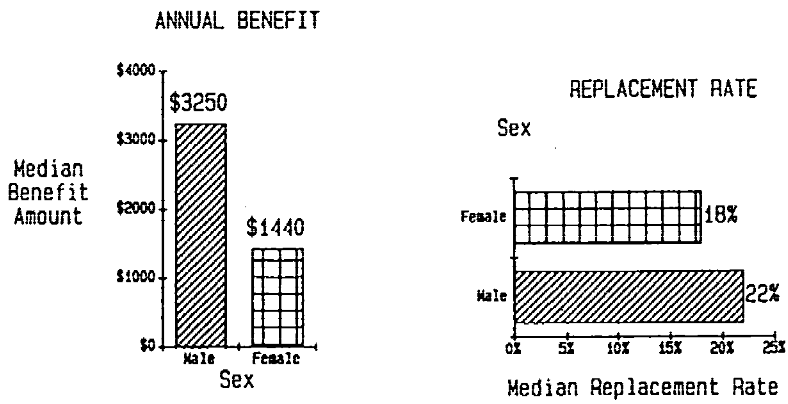
Average benefit levels from pension plans tend to be low. A Labor Department study of recent retirees from private pension plans projected the median annual benefit of 1977-78 retirees to be $2,650. This benefit replaced, at the median, 21 percent of pre-retirement earnings. Benefit levels for women were even lower -- the median annual pension for women was 44 percent of that for men, largely due to lower career earnings (see Chart 3).

What causes low pension benefits?

Three factors are most likely to cause low pension benefits: movement in and out of the labor force or pension-covered employment, job mobility and the length of stay on any one job, and features of pension plan formulas that may reduce pension benefits.

Career patterns have the greatest effect on the amount of benefits paid by pension plans. Workers who enter plans late in life or work short periods under a plan earn substantially lower benefits than those who enter early and work a full career. The Labor Department study found that the median benefit for workers with 10 years of service under their last pension plan replaced only 6 percent of their pre-retirement income while the median benefit of those with 35 years of service replaced 37 percent of pre-retirement income. Similarly, workers who entered the plan at a young age accumulated larger pensions than those who entered the plan late in life.

CHART 3
MEDIAN PENSION BENEFITS FROM FINAL PENSION PLAN BY SEX
WORKERS RETIRING WITH PENSIONS IN 1977-78



Source: U.S. Department of Labor, Office of Pension and Welfare Benefit Programs. Private Pension Benefit Levels. (Washington, D.C.: GPO) June 1985.

The median benefit level for women retiring in 1977-78 with a private pension was 44 percent of the median benefit level for men. Women's benefits, however, replaced 18 percent of pre-retirement earnings on average, compared to 22 percent for men. The combination of low benefits and comparable replacement rates indicates that much of the difference in benefit levels can be explained by lower career earnings for women.

2. COVERAGE

How much of the workforce is covered by a pension?

Only about half of the workforce is currently covered under a pension plan. Fifty-two percent of the 99 million American workers worked in 1983 for an employer with a pension plan and were included in the plan. The other 48 percent of the workforce either worked for employers who did not have a pension plan or were excluded from coverage by the employer (see Chart 4).

How can an employer exclude employees from a plan?

Under ERISA, employers can exclude part-time workers (working less than half time), new employees (with less than a year of service), young employees (under age 21), and older employees (hired within 5 years of the normal retirement age). Employers can also exclude collective bargaining units.

In addition, ERISA provides employers broad discretion in defining other groups of employees to be excluded from plan coverage. Employers are required only to cover either 70 percent of the remaining employees; or 80 percent of eligible employees if 70 percent of employees are eligible; or a classification of these employees if the classification is not discriminatory in favor of the highly paid.

Who is not covered by a pension plan?

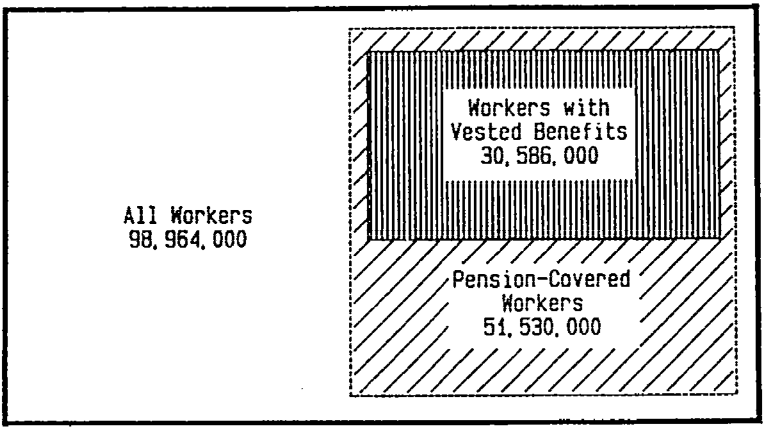
Forty-seven million workers were not covered by a pension plan in 1983. The largest group of uncovered workers (34 percent) were in their prime working years (25-64 years of age), working full-time (1000 hours or more), and had been on the job a year or more. Because they exceeded the ERISA standard at that time, most would have been covered had they worked for firms with pension plans.

Workers who did not meet the ERISA standard were in the minority among the uncovered. One in four uncovered workers was too young. Another ten percent of the uncovered worked part-time and an equal percentage had been on-the-job less than a year.

Workers not covered by a pension in 1983 were employed primarily by small firms and had low incomes. Nearly three-quarters of the non-covered workers in the private-sector worked for a company with fewer than 100 employees. Over 90 percent of the non-covered workers had earnings below $25,000, and nearly half had earnings below $10,000 (see Table 1).

The lowest rates of pension coverage occurred for workers in small firms, non-union workers, low earnings workers, and part-time workers. These factors overlap. For example, many workers have low earnings because they work part-time; and nearly all of the workers in small firms are non-union (see Table 2).

CHART 4
PENSION COVERAGE AND VESTING
TOTAL U.S. WORKFORCE
MAY 1983



Source: Emily S. Andrews. The Changing Profile of Pensions in America (Washington, D.C.: EBRI) Forthcoming.

While nearly all workers in the United States are covered by Social Security, only half are covered by an employer-sponsored pension plan. Merely being covered by a pension plan does not ensure that these workers will earn pension benefits. To earn the right to a benefit (i.e. "vest"), a worker must usually remain with the same employer for ten years.

As of May 1983, 52.1 percent of the workforce was covered by a pension. Of those covered, 59.4 percent were vested in their benefits.

TABLE 1
PENSION COVERAGE OF NON-AGRICULTURAL WAGE AND SALARY WORKERS
BY CHARACTERISTICS OF EMPLOYMENT

Characteristics	Total Employment (Thousands)	Number Covered (Thousands)	Number Not Covered (Thousands)	Percent of Non-Covered
TOTAL	88,214	49,530	38,684	100.0
Private Sector	61,223	31,629	29,594	76.5
Hours Worked				
< 1000 hours	8,181	2,253	5,928	16.6
1000-1999 hrs	18,740	9,454	9,286	26.0
2000+ hrs	57,884	37,318	20,566	57.5
Firm Size-Private				
< 100	27,860	6,384	21,476	72.6
100-499	8,290	4,819	3,471	11.7
500 +	25,073	20,426	4,647	15.7
Age				
<25	17,991	6,376	11,615	30.0
25-44	44,991	27,471	17,520	45.3
45-64	23,260	14,992	8,268	21.4
65 +	1,970	691	1,279	3.3
Earnings				
< $10,000	25,337	8,180	17,157	47.8
$10-24,999	41,211	24,909	16,302	45.4
$25,000 +	13,741	11,283	2,458	6.8
Job Tenure				
< 1 year	16,671	4,906	11,765	32.0
1-9 years	46,297	26,029	20,268	55.2
10+ years	23,053	18,360	4,693	12.8

Source: Emily S. Andrews. The Changing Profile of Pensions in America. (Washington: EBRI) Forthcoming.

TABLE 2
RATES OF COVERAGE BY GROUP
1983

Employer/Employee Characteristics	Pct of Workforce Covered by a Pension
Firm Size	
< 100	22.9
100-499	58.1
500 +	81.5
Union Membership	
Union	44.4
Non-union	81.6
Earnings	
< $10,000	32.3
$10-24,999	60.4
$25,000 +	82.1

Source: Emily S. Andrews, The Changing Profile of Pensions in America, (Washington, D.C.: EBRI) Forthcoming.

TABLE 3
PENSION COVERAGE BY INDUSTRY
1983

Industry	Covered Workers: Percent of Full-Time Workers	Covered Workers: Percent of ERISA Workforce
Communications and Public Utilities	87.2	90.5
Mining	73.4	82.7
Durable Manufacturing	73.5	79.8
Non-Durable Manufacturing	66.5	72.6
Finance, Insurance, and Real Estate	65.8	72.4
Transportation	57.0	65.9
Wholesale Trade	54.7	63.3
Professional Service	56.4	64.0
Retail Trade	36.6	46.0
Construction	35.2	44.6
Business Service	27.5	33.8

Source: Emily S. Andrews, The Changing Profile of Pensions in America, (Washington D.C.: EBRI), Forthcoming.

Coverage tended to be highest in the manufacturing sector and lowest in the service sector. Fewer than half of the workers in the retail trades, construction, and business service industries were covered by pensions (see Table 3).

Why do small firms not adopt pensions?

Small firms tend not to provide pensions for several reasons:

1) Many small businesses are newly formed and will be short-lived. A proprietor will often wait until the business is established and profitable before considering a pension. Even then, there may be a reluctance to commit to paying future benefits when the business may not be around long.

2) Pensions are costly to small business. Small businesses frequently have low profit margins, are labor-intensive, and operate in highly competitive business environments. The addition of a pension plan would add to labor costs and reduce profit margins, unless employees accepted reduced wages to fund the plan.

3) Small businesses benefit less from the tax advantages of a pension. The graduated corporate tax rates range from 17 to 46 percent depending upon a firm's income. The tax savings from pension contributions will be small for a low volume business.

4) The administrative cost and complexity of operating a pension plan often discourages small business owners from setting up a plan.

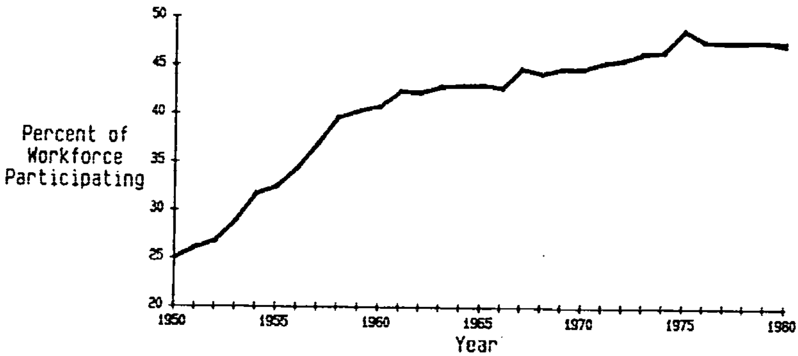
Will Coverage Expand?

The expansion of pension coverage has been slowing steadily over the last few decades. The most rapid growth in coverage occurred in the 1940s and 1950s when the largest employers adopted pension plans. Expansion of coverage slowed during the 1960s and '70s when a large number of small plans were created which covered only a small proportion of the workforce (see Chart 5).

Coverage actually declined slightly between 1979 and 1983 due to recession and the loss of jobs in the well-covered manufacturing sector and the increase in jobs in the poorly-covered service sector.

Projections of future trends in pension coverage have been hotly debated. However, it seems unlikely that pension coverage will grow much without some added incentive for small business to add pension plans and for employers to include part-time workers in their plans.

CHART 5
GROWTH IN PENSION COVERAGE - 1950-1980
PERCENT OF PRIVATE, NON-AGRICULTURAL, WAGE AND SALARY WORKERS PARTICIPATING IN A PENSION



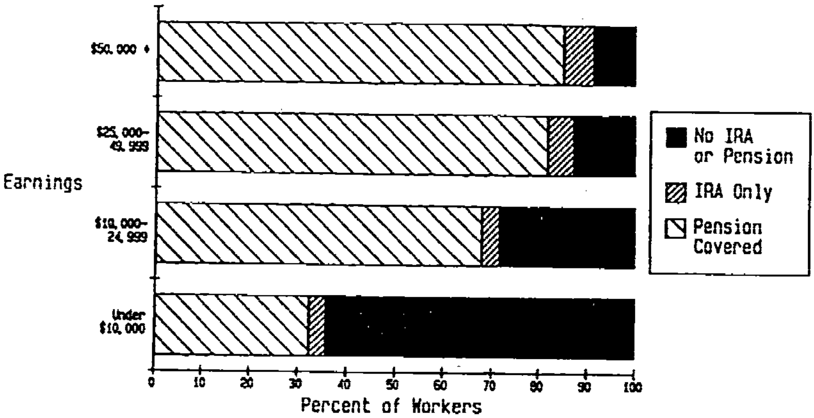
Source: Sylvester J. Schieber. Social Security: Perspectives on Preserving the System. (Washington, D.C.: EBRI) 1982. Table II-1.

Pension coverage expanded the most rapidly in the 1950s and '60s when large manufacturers adopted pension plans. In recent years pension coverage has stabilized with the loss of jobs in manufacturing and the growth of the poorly-covered service sector.

Have IRAs helped non-covered workers?

Congress enacted the Individual Retirement Account (IRA) provisions in 1974 to enable those not covered by a employer-sponsored pension to save for retirement. IRA coverage has only helped a small portion of the non-covered workforce (see Chart 6). IRAs have done the most to help the highly-paid non-covered worker, and have done relatively little to bring retirement savings to lower-paid workers.

CHART 6
COVERAGE BY RETIREMENT PLANS
BY EARNINGS
1983



Source: Emily S. Andrews. The Changing Profile of Pensions in America (Washington, D.C.: EBRI) Forthcoming.

Pension coverage is more widespread among workers with higher earnings. More than 80 percent of those earning more than $25,000 a year are covered by a pension, while only 32 percent of those with earnings below $10,000 are covered.

Although IRAs (Individual Retirement Accounts) were enacted in 1974 to give non-covered workers a way to save for retirement, IRAs have failed to increase coverage by much. Use of IRAs by non-pension covered workers is highest among those with higher earnings.

3. JOB MOBILITY

Pension-coverage does little good if workers lose benefits due to a job change. The clearest benefit loss occurs if the worker leaves before vesting in a pension. But even departing workers who stay long enough to vest may lose benefits because of the way the plan accrues benefits or because they spend a cash distribution of their pension accrual when they leave the plan. These factors in combination result in a redistribution of pension benefits from "leavers" to "stayers".

A. VESTING

What is vesting?

Vesting is earning the right to receive benefits from a pension plan. Someone who is merely covered by a pension plan will not necessarily receive any benefits from that plan. To receive a benefit the worker must vest under the plan.

Most pension plans require that a worker remain on the job for a specified number of years to receive any benefits. If a plan has a 10-year vesting rule that means that someone leaving the company before they have completed 10 years of service will not receive a pension benefit.

Why do employers have vesting rules?

Vesting is one of the features of a pension plan intended to encourage employees to stay with the company. Hiring and training workers can be costly to employers. To reduce job turnover and keep good workers, employers often hold out the promise of better compensation in the future. A pension is one way for a company to systematically reward worker loyalty without causing resentment among other workers.

Vesting provisions are a simple way to make sure benefits do not go to short-term workers. Because the rules are clear to workers, vesting rules have been shown to be effective in reducing the rate of job quits among those who are a few years short of vesting.

How long do workers have to stay on a job before they vest?

Vesting rules vary, but the most common rule requires that a worker remain for 10 years to vest any pension benefit. Nearly 80 percent of the workforce are in plans that do not fully vest before 10 years. Defined contribution plans tend to have earlier vesting than defined benefit plans - more than half of the workers in defined contribution plans are in plans that fully vest in less than 10 years.

ERISA specifies three alternative vesting standards that plans must meet or exceed. The most popular standard is 10-year "cliff" vesting - requiring a plan that vests no portion of the benefit before the vesting date to vest the entire benefit before the end of the employee's tenth year. The other two ERISA standards relate to "graded" vesting, where part of the benefit is vested each year over several years.

In addition, in recent years concern over potential abuses in small plans has led the IRS to require some plans to vest more rapidly, and led the Congress to require that plans providing a large portion of their benefits to "key employees" (so-called "top-heavy plans") fully vest benefits in 3 years.

Why are ERISA's vesting rules an issue?

Because most workers do not stay on a job for ten years, ten year "cliff" vesting deprives a large portion of the workforce of pension benefits they otherwise could have earned on pension-covered jobs.

The probability that a worker starting a job will remain on the job for ten years is low. Males working full-time have the longest job tenure (see Table 4). Even then, there is less than a 50-50 chance that a male entering a job will remain for ten years even when starting as late as age 45 (see Chart 7).

Job turnover is highest among the young and declines for older workers. Some analysts contend that although workers tend to change jobs frequently when young, they eventually settle into jobs where they vest in pensions. The average worker in the U.S., according to labor economist Robert Hall, holds ten jobs over a lifetime, eight of these jobs by age 40. This typical worker does not stay long enough on a job to vest in a pension benefit (under a 10 year rule) until age 45, and then only holds two jobs longer than 10 years with short periods of service in each.

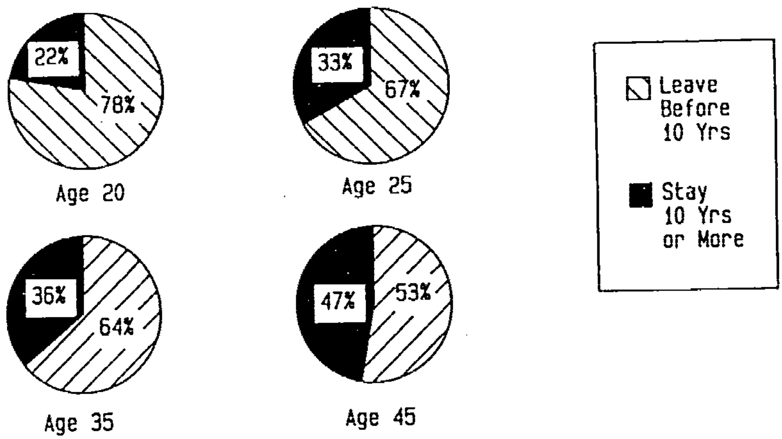
Ten-year vesting affects women disproportionately. Not only do women not gain vested pension rights from early employment, but mid-career departures for child-rearing give them a later start in vesting benefits from late-career employment.

The trend towards shorter job tenure and greater mobility makes 10-year vesting even more of a problem for the future. The average job tenure for males age 40-44, for example, dropped from 9.5 years in 1966 to 8.0 years in 1981 (see Chart 8). As a result, in 1981 only 36.3 percent of the men 35-44 years of age had been on the job 10 years or more, compared to 40.4 percent in 1966.

Although women's job tenures are now shorter on average than men's, women's job tenures are not declining. The increasing tendency for women to remain in the labor force for a full career appears to be offsetting any general decline in their average length of stay on a job (see Table 5).

CHART 7

PERCENTAGE OF FULL-TIME MALE WORKERS REMAINING ON THE JOB TEN YEARS BY AGE OF JOB ENTRY



Source: David L. Kennell and John F. Sheils. Revised Documentation of the ICF Pension and Retirement Stimulation Model (Washington, D.C.: ICF Incorporated) February, 1984.

Restrictive vesting rules in pension plans prevent many workers from earning pension benefits from their employers - even though they are covered by the pension plan. While most pension plans require workers to stay for 10 years to earn a benefit, most workers change jobs more frequently than every 10 years.

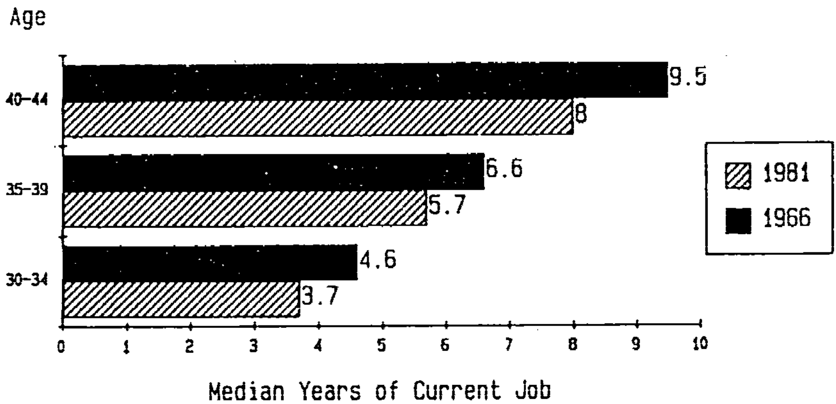
The oldest workers show the most job stability. While a male starting a job at age 20 has only a 22 percent chance of staying 10 years on that job, a male starting a job at age 45 has a 47 percent chance of staying 10 years or more. Even those who start a job late in life, however, have only a little better than 50-50 chance of staying on that job long enough to vest in a pension. The chances of a woman remaining on the job ten years are even less.

TABLE 4
PROBABILITY OF A MALE WORKER REMAINING ON A JOB TEN YEARS BY AGE OF JOB ENTRY

Age	Probability
Full Time Workers	
Age 20	0.22
Age 25	0.33
Age 35	0.36
Age 45	0.47
Part Time Workers	
Age 20	0.09
Age 25	0.15
Age 35	0.19
Age 45	0.33

Source: ICF, Inc. Revised Documentation of the ICF Pension and Retirement Simulation Model, February 1984.

CHART 8
MEDIAN YEARS ON CURRENT JOB
MEN AGE 30 TO 45
1966 AND 1981



Source: U.S. Bureau of Labor Statistics. Special Labor Force Report, Nos. 77 and 2162. (Washington, D.C.: GPO).

Job tenure among men in the middle age ranges has dropped substantially since 1966. Job tenure among women has been more stable, showing the effects of increasing labor force participation for full working careers.

TABLE 5
MEDIAN YEARS ON CURRENT JOB BY AGE GROUP
1966 AND 1981

Age Group and Sex	Median Years on Current Job	
	1966	1981
Male		
20-24	1.0	1.1
25-29	2.3	2.3
30-34	4.6	3.7
35-39	6.6	5.7
40-44	9.5	8.0
45-49	10.6	10.3
50-54	12.6	11.8
55-59	15.2	14.8
60-64	16.5	14.6
65-69	14.6	10.4
70 +	16.9	10.2
Female		
20-24	1.1	1.0
25-29	1.8	1.8
30-34	2.0	2.3
35-39	3.0	3.0
40-44	4.1	3.9
45-49	5.1	5.1
50-54	6.2	6.8
55-59	7.8	8.5
60-64	11.2	10.0
65-69	10.2	9.5
70 +	13.2	11.2

Source: U.S. Bureau of Labor Statistics. Special Labor Force Report, No. 77 and No. 2162.

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B. BENEFIT ACCRUALS

What are benefit accruals?

Benefits paid by a pension plan are a function of a worker's length of service under the plan. All plans have formulas that specify how much is accrued for each year of service under the plan. In a defined contribution plan there is an annual contribution of "x" percent of pay to the worker's account each year. In a defined benefit plan the promised retirement benefit is increased a specified amount for each year of service - a typical defined benefit formula would pay:

(1.5% of "final average pay") x (years of service).

The added amount of contribution or earned benefit for a given year is the "benefit accrual" for that year.

Why are accruals an issue?

Even when they vest, workers lose pension benefits under some plans when they change jobs. The pension loss results from the way some plans accrue benefits.

How does changing jobs "damage" pension benefits?

All plan formulas do not accrue benefits uniformly over a worker's career. Some plans do -- defined contribution plans credit a worker with a fixed percent of pay each year. Defined benefit plans basing benefits on "career average" pay also credit each year at a fixed percent of each year's pay.

Defined benefit plans that pay benefits based on the worker's "final-pay", however, credit all years of service at the pay a worker earned just before leaving the plan or retiring. A pay increase in any year raises the value of benefits earned in previous years. Thus, final-pay plans accrue most of the benefit in the years just before retirement.

Final pay formulas have been popular with employers because they relate the pension benefit to the worker's earnings immediately preceeding retirement. However, final pay plans penalize workers who leave the plan before retirement. The benefits of a worker leaving a final pay plan early are "frozen" at the last pay level under the plan. The further a worker is from retirement, the less valuable the pension benefits will be.

A mobile worker earning benefits under a number of final-pay plans will receive much lower benefits than a steady worker who spends a full career under a single plan. Table 6 illustrates the "damaged benefit" a mobile worker receives. In this illustration a worker who changes jobs every 10 years receives 50 percent of the benefits of the worker who remains under a single plan for 30 years. The mobile worker earns almost two-thirds of his benefits in his last plan.

TABLE 6-
EFFECT OF MOBILITY ON BENEFITS
IN FINAL-PAY PENSION PLANS

Years of Service	Final Pay	Benefits[1] Mobile Worker	Career Worker
Initial	$ 2,600	..	..
10	5,879	$ 587.90	N.A.
20	13,291	1,329.10	N.A
30	30,051	3,005.10	$9,015.30
Career Total:		4,922.50	9,015.30

Source: Memorandum prepared by Edmund M. Chopko, Towers, Perrin, Forster, & Crosby, for Howard Weizmann, Manager Corporate Benefits, Sun Company, Inc., November 5, 1984.

1. Benefits are based on a single final-pay benefit formula: 1 percent of pay at termination times years of service. Each employee begins with annual earnings of $2,600 which increase at 8.5 percent a year to $30,000 after 30 years. The mobile worker changes jobs every 10 years. The career employee spends 30 years under the same plan.

C. PORTABILITY

What is portability?

Vested workers who change jobs retain the right to receive "vested deferred benefits" when they reach retirement age. Until then, their benefits or credits usually remain with the plan and are not "portable". Critics of the pension system have long stressed the need for a mechanism to enable mobile workers to transport and accumulate their pension credits from job to job.

Portability is the transfer of pension accruals or pension credits to an individual retirement account, central portability fund, or hiring employer's pension plan. In this way workers can accumulate their accruals or credits, possibly invest them, and receive a single benefit at retirement.

Are pensions portable now?

Only a few pension plans have formal "reciprocity" agreements to exchange pension credits with other plans. Instead, many pension plans respond to the departing worker's demand for portability by providing a lump-sum cash distribution of his or her accrued benefits.

Defined contribution plans are the most likely to provide cash distributions, since each employee has a distinct account already fully funded by the employer. Congress has encouraged lump-sum distributions by providing extremely favorable tax treatment for them through the use of ten-year forward averaging.

ERISA sought to encourage employees to save their lump-sum cash distributions by rolling them over to hiring employers' plans or IRAs. The ERISA provision defers taxes on distributions that are rolled over within 60 days.

At the same time, ERISA made the lump-sum distribution more prevalent by permitting employers to "cash-out" accruals of $1750 or less without the consent of the employee, to ease the burden of administering small vested deferred benefits. This amount was increased to $3500 in 1984.

Have lump-sum distributions and IRA rollovers improved portability?

To the extent that workers receive lump-sum distributions from pension plans, they tend to spend them rather than save them. There is not much evidence that workers actually rollover distributions to either IRAs or other plans. Thus, distributions appear to reduce retirement income rather than increase it.

The proportion of departing workers who receive lump-sum distributions is not known. Evidence suggests, however, that those who take distributions usually spend them. Recent data from the EBRI/HHS Pension Supplement to the May 1983 Current Population Survey indicate that only 5 percent of lump-sum distributions are saved in a retirement account, and only 32 percent are saved in any form, including through the purchase of a home. Lump-sum distributions are most likely to be saved if the amount is large and the worker is older and better educated. Even then, fewer than half of the workers roll their distributions over into a retirement savings account.

How would a portability mechanism help?

Proponents of a portability account or clearinghouse generally contend that portability of benefits or service credits would reduce the loss of benefits by discouraging lump-sum distributions and would improve benefits through investment before retirement.

Defined benefit plans present the greatest obstacles to pension portability. Analysts contend that even sound investment of pension cashouts from these plans would not improve them much beyond what the plan would pay if the accruals were left in the plan. In addition, the technical problems of valuing credits or cash payments fairly when they are transferred to the portability account may be insurmountable.

Defined contribution plan benefits are the easiest to transport and for this reason are often used with highly mobile workforces. A simple mechanism to ensure the benefits are rolled over to a portability account would solve most problems with these plans.

4. PENSION INTEGRATION

What is pension integration?

Employers who want to fit their pension benefits together with Social Security benefits to achieve specified income replacement targets for their retirees use integration to accomplish this goal. The integration rules in the Internal Revenue Code permit plans to take Social Security into account in the pension formula without being considered discriminatory.

How does pension integration work?

There are two main methods of integration: excess and offset. Under excess rules, employers may use a higher contribution rate or pay a higher benefit on pay above the Social Security taxable maximum ($39,600 in 1985) than they use on pay below it. The IRS requires that the difference in contribution rates above and below the integration level not exceed 5.4 percent, and the difference in benefits not exceed 37.5 percent.

In a pure excess method, the employer may make no contributions or pay no benefits below the integration level, and contribute 5.4 percent of pay or pay 37.5 percent of pay above the integration level. In a step-rate method, the employer might contribute ~~10~~ 8.4 percent of pay above the integration level and 3 percent below.

Under offset rules, the plan reduces the pension benefit by some proportion of the individual's Social Security benefit. For example, a plan with integration might pay a benefit equal to:

(1.5% of pay) x (years of service) - (50% of Social Security)

In no case may the plan use more than 83.3 percent of the Social Security benefit in reducing the pension. Large employers characteristically use no more than half of the Social Security benefit.

Why do employers use pension integration?

Most employers have designed their benefit formulas to replace a specified percentage of pre-retirement earnings when combined with Social Security. Since Social Security benefits replace a higher percentage of income for the low-paid than the high-paid, employers aim pensions to add on a higher percentage of income for the high-paid than the low-paid, with the intention of achieving fairly similar replacement rates for all workers. Integration enables the plan to achieve this objective simply.

Some types of pension plans do not use integration, but instead design the pension formula to achieve the same objective. Many collectively bargained pension plans pay "flat-dollar" benefits - they pay a fixed benefit amount times years of service.

The benefit level usually increases with pay classifications or wage scale and thus is effectively integrated with Social Security without having to offset the benefits.

Employers contend that since they pay half of the Social Security tax and usually all of the pension contribution they should be able to integrate the two. In the case of the excess rule, the employer contributes 5.4 percent below the integration level to Social Security Old Age, Survivors, and Disability Insurance and thus can make a 5.4 percent higher pension contribution above that level than below it. In the case of the offset rule, the employer takes the 50 percent of the Social Security benefit from his contributions into consideration.

Why is pension integration an issue?

There is controversy over whether an employer should be able to use pension integration at all. Some contend that any form of integration is unfair because it reduces pension benefits for low-wage workers.

Whether integration itself is unfair or not, there is general agreement that pension integration can be used unfairly and can be used to deprive workers of legitimate benefits. The most abusive type of integration method is the pure excess method - where an employer makes no pension contributions below the integration level. In this case the employer is permitted to have a tax-qualified pension plan but provide benefits only to higher-paid employees.

An additional issue of general concern is the ability to totally eliminate pension benefits through the offset rules for certain employees. This can happen for two reasons. First, in cases where pension benefits are small and Social Security benefits are much greater, the reduction of the pension by 83.3 percent or even 50 percent of the Social Security benefit can eliminate the benefit. Second, it is possible for employers to use the entire Social Security benefit to offset a pension when only a portion of the worker's Social Security benefit was earned on that job.

TABLE 7
INTEGRATION EXAMPLES

EXCESS RULE:

Plan Contributes: 5% of compensation on pay below $39,600
10% of compensation on pay above $39,600

Worker A

Pay: $25,000

OASDI tax
(employer share): $1,350

Plan Contribution
(5% x 25,000) : 1,313

TOTAL:
Contribution: 2,663
% of Pay: 10.7

Worker B

Pay: $50,000

OASDI tax
(employer share): $2,138

Plan Contribution
(5% x 39,600) +
(10% x 10,400) : 3,020

TOTAL:
Contribution: 5,158
% of Pay: 10.3

OFFSET RULE:

Plan pays:
(1.5% of final pay) x (yrs of serv) - (50% of Soc Sec)
Worker retires in 1985 at age 65 with 30 years of service.

Worker A

Final Pay: $25,000

OASDI Benefits: $ 750/mo.
replacement rate: 36%

Pension Benefit
(w/o integration): 940/mo.
replacement rate: 45%

TOTAL BENEFIT:
750 + [940 - .5(750)] = $1,315
replacement rate: 63%

Worker B

Final Pay: $50,000

OASDI Benefits: $ 930/mo.
replacement rate: 22%

Pension Benefit:
(w/o integration): 1875/mo.
replacement rate: 45%

TOTAL BENEFIT:
930 + [1875 - .5(930)] = $2,340
replacement rate: 56%

ITEM 2

Testimony of the National Federation of Business and Professional Women's Clubs, Inc.

BPW/USA, the National Federation of Business and Professional Women's Clubs, Inc., founded in 1919 to improve the status of women in the workforce, is dedicated to promoting full participation, equity and economic self-sufficiency for working women. Today, with a membership of 150,000 women and men, there are 3,500 BPW/USA chapters with at least one chapter in every Congressional district in the United States. As the voice of working women and in keeping with our objectives, BPW/USA has worked for more than a decade for pension reform. More specifically, we seek changes which will make the private pension system more responsive to the needs and work patterns of American workers, and particularly, women workers.

Historically, pensions have been viewed as gifts toward workers in "recognition of 'long and faithful service,' and...no legal rights were thereby given to employees who became beneficiaries of a plan." That view, a product of the 19th century work ethic, was not inclusive of women and should no longer be applicable in today's society where job mobility is common. More recently, Congress has been forced to intervene to protect workers from fraud and corruption within the private pension system. A little more than a decade ago, Congress passed major legislation — the Employee Retirement Income Security Act (ERISA) — to protect workers from just such abuse.

In 1984, Congress passed another piece of legislation, the Retirement Equity Act (REA) to change some provisions of ERISA which negatively affected women. REA lowers the minimum vesting age from 25 to 21; requires a spouse's written permission before an employee waives survivor benefits; and liberalizes rules related to breaks-in-service. While the law is clearly a first step toward retirement equity, further changes are needed to expand pension protection to all workers.

The present pension system rewards workers who have steady careers with low job mobility and substantial earnings. Women, who comprise 43 percent of the total labor force, are largely excluded from such a system. The typical woman worker has a very different employment pattern; she is in a female-dominated occupation, earns less than the average man and changes jobs more frequently. The media attention focused on the career woman in no way reflects the current status of working women. Most still earn only 63 cents for every dollar earned by men. This is a major factor contributing to the feminization of poverty generally and to the poverty of older women.

In 1983, almost 17 percent of women 65 and over were living at or below the poverty line compared with 10 percent of men.

The numbers of older women in poverty will continue to grow as the income gap between women and men 65 and over continues to widen. The average total annual income for women 65 and over was $4,757 in 1981 while for men it was $8,173. In 1983, although the average total income for both women and men rose — $5,599 for women and $9,766 for men -- so did the disparity between the two, by $751. Similarly, the gap is also increasing between the numbers of men and women receiving any private pensions. In 1983, only 11 percent of women 65 and over received private pensions or annuities while 30 percent of men received some benefits. For women, this represented a meager .5 percent increase from 1981 compared to a more than 2 percent increase for men over the same time period. These statistics clearly reveal that the current pension system does not adequately protect many American workers, least of all women.

Private pensions represent a critical and increasingly necessary component in maintaining an adequate standard of living at retirement. Private pensions, social security and personal savings combined are needed to provide adequate retirement income for American workers. Social security benefits alone are inadequate, yet, 60 percent of women living alone or with an unrelated person (Social Security and the Changing Roles of Men and Women, p. 183, HEW, 1979) depend on these payments as their only source of income. Clearly, women need the income that pension benefits can provide.

Until the millions of employed women in America have access to adequate private pension benefits, they will continue to make up a disproportionate number of those older Americans living in poverty.

Specific reforms are needed in the areas of coverage, vesting, integration, and portability to make the private pension system truly fair.

I. Coverage

Comprehensive coverage is an important step toward retirement equity. Women workers, however, haven't had equal access to pensions largely because they have been clustered into lower-paying, female-dominated jobs -- jobs that are not likely to offer pension benefits. Women continue to be disproportionately represented both in low-paying jobs and in occupations with the lowest numbers of pension plans -- trade (only 37 percent of workers covered in 1979) and service (only 33 percent covered). The most recent figures, compiled by the Bureau of Labor Statistics in 1981, reveal that women comprise 80.5 percent of all clerical workers; 62 percent of all service workers; and 45.4 percent of all sales workers. Fewer than half the women in these jobs will be covered by pension plans.

The stratification of women into these lower-paying jobs translates into less pension coverage and ultimately no pension benefits for many women workers. In addition, employers can exclude certain classes of employees (secretaries, for instance). Since women occupy most clerical and other low-paying positions, they are often the victims of these "exclusionary clauses". BPW/USA strongly supports amending ERISA to prohibit "exclusionary clauses" and we urge policy makers to explore new ways of encouraging employers to provide pension plans for employees.

Older workers also find themselves in precarious coverage situations. Currently, many programs provide coverage to all workers except those who start work within five years of the plan's normal retirement age. Further, after age 65, accrual of benefits is usually frozen even if the employee continues working. Arbitrary age discrimination in coverage is unwarranted and should be eliminated. In addition, BPW/USA supports giving credit toward pension plans for employees who work after the plan's normal retirement age.

Part-time workers - mostly women - are often the victims of discriminatory coverage practices. Women are more likely to work part-time because of familial responsibilities. Department of Labor statistics show that "more than one-fourth (28 percent) of all women workers held part-time jobs in 1981; a great majority of them (78 percent) were employed on a voluntary part-time basis.

About 66 percent of all part-time workers were women." Yet, part-time workers must work at least 1,000 hours per year to receive pro-rated credit. BPW/USA supports pro-rated credit toward vesting if employees work 500-999 hours per year.

II. Vesting

Minimum vesting requirements must be lowered. (Vesting is the legal, non-forfeitable right to receive accrued benefits at retirement.) Current vesting practices disqualify many full-time and part-time workers, especially women. While 47 percent of the workforce is covered, only 22 percent actually receives pension income. For women, the situation is worse — only 11 percent of the women ostensibly covered ever receive a pension payment. This disparity is partially the result of outdated vesting practices. In 1982, the Bureau of Labor Statistics reported that 88 percent of workers covered by medium and large-sized firms had to serve 10 years to vest their right to a future benefit. In January 1983, 50 percent of the full-time civilian workforce over 16 had worked for their current employer 4.4 years or less (men-5.1 years, women-3.3 years), and 73 percent had worked for their current employer less than 10 years (men-67 percent, women-79 percent).

Current vesting practices do not take into account job mobility which, as Geraldine Ferraro wrote in Pensions and Investment, is "no longer a sign of irresponsibility or lack of commitment. It's an economic reality that should not be punished by an insecure old age." <u>To ensure that workers who are covered will be vested, we support five-year vesting with a phase-in to three-year vesting.</u>

III. Integration

Even if coverage is extended and vesting requirements lowered, workers who qualify for pensions may not actually receive any benefit because of pension integration. This widespread, though rarely mentioned, practice allows companies to take social security into account when calculating an employee's pension benefit. Integration is a form of discrimination against lower paid employees. The amount of money "integrated out" of lower-paid employees' pensions goes back to compensate higher-paid employees.

One method of integration, the offset method, illustrates the devastating effects of pension integration. According to current law, an employer can deduct up to 83 1/3 percent of social security benefits from pension plans, but generally they deduct 50 percent. The following example illustrates how this works:

Mary Smith (fictional character), who earned $15,000 yearly, was about to retire at age 65 after working 10 years for the Typewriter corporation. Her employer will calculate her pension benefit by multiplying the following elements together: 1. a percentage based on the highest five years of average monthly earnings, which in this case is 1.2 percent; 2. the number of years she's worked for the company; and 3. her average monthly earnings over the last five years ($1250). When multiplied together, the pension benefit payment that Mary Smith is entitled to is $150 per month. Since her plan is integrated, her company will subtract 50 percent of her monthly social security benefit, which is approximately $544, from her pension benefit. When the company subtracts 50 percent ($272) from her pension benefit, ($150), Mary Smith is left with no pension. Many workers find themselves in similar situations because of integration. This practice has worked to the detriment of lower-paid workers, most of whom are women. Since many workers are harmed by integration, BPW/USA believes that the practice should be eliminated.

IV. Portability

Employees also need pension benefit protection when they leave a job after they have vested with their employer. Developing a portable pension plan is one way of protecting employee's benefits.

Donald Grubbs, in his testimony before the Select Committee on Aging in 1983, argued that "a federal portable pension system is needed now to preserve pensions that are vested under current law." Further, he explains that "if vesting requirements are accelerated for all plans, producing more small vested pensions, the need for a federal portable pension system would be even greater." The lack of portability, he says, often causes individuals to receive smaller pension benefits. For women workers, the problem is even more acute. <u>BPW/USA supports instituting "portability" of vested pension credits from one plan to another with incentives to employers who implement this procedure.</u>

All American workers can benefit from comprehensive pension coverage. Problems with the current private pension system can be resolved through implementation of these reforms. With these changes, comes the realization that pensions are not gifts — they are earned benefits that replace lost wages. These earned benefits are subsidized by all Americans through the tax system and should be distributed fairly. Congress has the responsibility for ensuring that no worker, because of pension inequities, be faced with poverty in later life.

ITEM 3

EXECUTIVE SUMMARY — TESTIMONY OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS BEFORE THE SENATE SPECIAL COMMITTEE ON AGING, JUNE 14, 1985.

The American Association of Retired Persons (AARP) is the nation's largest aging organization representing the interests of over 19 million members. AARP believes that comprehensive changes are needed in the private pension system so that it can become a reliable source of retirement income.

The current private pension system is not meeting the needs of millions of Americans who have spent all or most of their adult lives in the labor force. Despite the enormous tax subsidy that the system now enjoys (almost $40 billion in 1985) it is not now reaching most retirees, and without major changes, will not be a significant source of income for future retirees.

Comprehensive changes are needed in the private pension system. The system's failure to provide universal coverage, early vesting, inflation protection and portability of pension credits seriously limits its importance as a reliable source of retirement income for most workers. The simple fact is that employees _earn_ pension benefits, and contributions to plans are made in lieu of direct compensation. Pension benefits are no longer a reward, but a right, and the employee is entitled to the benefits of that right. Therefore, we must now institute coordinated reforms that will make the system operate more fairly.

While over 90 percent of the elderly receive income from Social Security, only one in four receives any private pension income. For recent retirees, half of the couples and two-thirds of the unmarried individuals who receive private pensions, get less than $100 from this source.

In order to receive a pension, a worker must first overcome a series of obstacles. The following are some of the problems that must be addressed to ensure pension adequacy.

Coverage: Approximately half of all workers are covered by a pension plan, but coverage varies greatly for different groups of workers. Workers who are unionized or employed by large firms are most likely to be covered. Part-time workers can be excluded from coverage as can new employees who are approaching retirement age. This pattern of coverage means that some groups of workers are much less likely to be in covered employment.

Vesting: Even if an individual is covered, he/she must vest before getting any benefit. Many plans use ten-year "cliff" vesting -- employees get no benefit unless they are in the plan ten years. Job mobility is a fact of American life. It is extremely common among younger workers, but also prevalent among middle-aged and older workers. For example, in 1983, over half of all employees between 35 and 64 had job tenure of fewer than ten years. Long minimum vesting schedules do not reflect the real work patterns of Americans. Therefore, lower vesting requirements are essential if more workers are to qualify for pension benefits.

Integration: If a worker is in covered employment and vests, he/she may still receive a reduced benefit or no benefit at all. Many plans integrate Social Security and pension benefits, reducing an individual's pension by some percentage of their expected Social Security. The result of the practice of integration is to reduce or altogether eliminate pension benefits for lower paid employees.

Inflation Adjustments: When a worker retires, his/her pension is fixed and may never be increased to keep up with the cost-of-living. While many plans do provide ad hoc adjustments, only about three percent provide automatic inflation adjustments. Even in times of moderate inflation, this means that most retirees receiving a pension suffer a loss of purchasing power each year.

Portability: A necessary corollary to any reforms in vesting and coverage is a system of portability that allows individuals to transfer vested pension credits. Currently, small vested benefits are often cashed out in lump sums and are not preserved to provide retirement income. With shorter vesting periods, this problem would be increased and the objective of providing an adequate retirement income would be frustrated. The need for some system of portability is greatest for lower income workers, who are most likely to spend lump sum payments, and who are most in need of an adequate pension in the future.

We must now seriously consider options for expanding coverage, lowering vesting, reducing the impact of integration, building in inflation protection and establishing a system of portability so that future retirees can look forward to a decent standard of living throughout their lives. Without necessary changes, the private pension system will continue to be an empty promise for most American workers and their families.

ITEM 4 Attachment 1

EBRI

P-19

Coverage Under Employer-Sponsored Retirement and Capital Accumulation Plans

by

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Emily S. Andrews earned her Ph.D. in economics from the University of Pennsylvania. Before joining EBRI she held policy research positions at the Social Security Administration and the U.S. Department of Labor.

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SUMMARY

Who is Covered by Employer-sponsored Retirement Plans?

Coverage and vesting are broadly based. Most nonfarm employees work for an employer who sponsors some type of pension or retirement plan; 56 percent of 88 million nonfarm workers said they were covered under a plan. Many of these workers expect to receive benefits at retirement. Of the 50 million covered workers, 22 million or 45 percent are eligible for a pension. Another 6 million, or 13 percent of covered workers, expect to receive a lump-sum distribution from their plan when they leave their job. Employees who expect either type of vested benefit sum to 58 percent of covered workers.

Most covered workers earn relatively modest salaries. This finding seems contradictory since coverage rates increase with earnings. However, over 76 percent of all covered employees and 70 percent of all vested employees earn less than $25,000 a year.

Workers are more likely to be vested as they reach retirement age. Among workers age 60 to 64, 70 percent in the private sector have vested benefits and 88 percent of government workers are entitled to a pension or a lump sum distribution from their current job. Coverage from previous employment could increase retirement income. However, most employees (71 percent) spend lump sum distributions they receive before retirement instead of saving them.

Who is Not Covered by Employer-sponsored Plans

Noncovered workers can be sorted into five categories. Fifteen percent of noncovered workers are self-employed. These workers appear to reinvest their savings in their own businesses instead. Three percent of noncovered workers are in agriculture. These workers are seasonal and have a number of other employment problems. Twenty-seven percent of noncovered workers are under age 25 or age 65 and over. Through the Retirement Equity Act (REA) employers will have to include 583,000 additional younger employees in their pension plans. Only time will tell whether more young workers will seek employers who provide pensions.

Workers without coverage who were on the job less than a year or who usually worked less than 1,000 hours account for another 20 percent of all noncovered workers. Those who met all 1983 ERISA participation standards make up the remaining 34 percent of all noncovered workers. They represent 16 percent of total employment.

Noncovered workers meeting ERISA participation standards (or who could expect to meet those standards) are different from those who are covered. Noncovered workers are more likely to work in small firms with fewer than 100 employees (68 percent compared to 17 percent). They are less likely to work under a union contract (10 percent compared to 38 percent). Noncovered workers also tend to have lower earnings and shorter job tenure.

Although individual retirement accounts were initially established through ERISA to help noncovered workers fill their pension gap, only 12 percent of noncovered workers contributed to an IRA in 1982 compared to 17 percent of all nonfarm employees.

Recent Trends in Employer-Sponsored Coverage

To evaluate the coverage issue, we need to know how coverage has changed over the past few years. The coverage rate fell between 1979 and 1983 among nonfarm workers from 61 percent to 56 percent. Declines took place among both private sector and government employees. Over the same period the relative fraction of covered workers who are women has increased.

Declining coverage rates may have been caused by the 1982 recession and generally poor economic conditions. An analysis by industry of workers meeting ERISA participation standards in 1983 shows the composition of the decline in greater detail. Some industries, like durables manufacturing, had losses in employment and in pension coverage. Others showed little change in employment and little if any coverage expansion. By contrast employment and coverage increased in the service sector and coverage rates remained relatively unchanged.

Economic expansion since the May 1983 survey may have produced renewed growth in coverage. Other evidence suggests that coverage may have been affected by post-ERISA legislation such as ERTA and TEFRA. Statistics for 1984 and 1985 are needed to determine whether legislative change has reduced coverage growth. Few analysts are forecasting the type of robust growth in pension coverage experienced before 1979.

Coverage rates fell for both men and women. But declining coverage affected men to a greater extent. The number of women workers grew between 1979 and 1983 while the number of men shrank. As a consequence, 39 percent of covered workers were women in 1979 compared to 42 percent in 1983. The coverage rate for women is still lower than that for men, however.

What Influences Pension Coverage?

Whether an employee has employer-sponsored coverage depends on the characteristics of the workplace and characteristics of the employee. A statistical analysis undertaken by EBRI shows that four factors more closely related to the employee-- age, hours of work, job tenure and wages -- account for 32 percent of the variation in coverage. Industry differences account for another 17 percent of the variation.

The major difference in coverage rates stems from only two sources -- firm size and unionization. Large firms, whether or not unionized, usually have pension plans. The coverage rate for firms with more than 500 employees is 82 percent. That for firms with fewer than 100 employees is 23 percent.

The coverage rate for private sector employees under a collective bargaining agreement is 82 percent; that for nonunionized employees is 44 percent. Small firms that are unionized are more likely to provide coverage than small nonunionized firms.

These figures suggest that if policies could be divised which would increase the extent of coverage among small firms, many more workers would qualify for pension benefits at retirement. EBRI simulations show that if firms with fewer than 100 workers were as likely to have a pension plan as firms with 100 to 500 workers, 7.6 million more employees would be covered; of these, 3.6 million would be vested.

The challenge is to devise policies to encourage expanded coverage without producing adverse indirect effects on workers or firms. I hope the information we have provided can help you meet that challenge.

INTRODUCTION

A national retirement income policy should address the issue of pension coverage. To aid the Congress in its considerations on this subject, this paper provides information based on a survey of individuals sponsored by EBRI and the U.S. Department of Health and Human Services in May 1983. This survey provides the most comprehensive information on coverage available.

I plan to discuss four topics in my testimony today:

- Who is covered by employer-sponsored retirement plans;
- Who is not covered by employer-sponsored plans;
- Recent trends in employer-sponsored coverage; and
- What influences pension coverage.

EBRI was formed in 1978 as a non-profit, non-partisan, public policy research organization to conduct research and educational programs. EBRI is committed by charter to the premise that the nation is served in social and economic terms by the existence of employee benefit programs. We are aware that there may be limits to what can and should be provided. Consequently, EBRI undertakes to provide studies and statistics that will allow informed priority decisions to be made upon assessment of documented costs and benefits.

WHO IS COVERED BY EMPLOYER-SPONSORED RETIREMENT PLANS

Pension coverage is widespread throughout the labor force.[1] Most nonagricultural wage and salary workers report working for an employer who sponsors some type of pension or retirement plan. This concept is generally referred to as pension coverage. In 1983, 56 percent of the 88 million nonagricultural wage and salary workers reported coverage under an employer-sponsored plan.

Another labor force group of relevance to the Congress consists of nonagricultural employees age 25 to 64 working 1000 hours or more who have worked on their jobs for at least a year. This group is called the "ERISA" work force because the workers meet ERISA standards for plan participation. The "ERISA" workforce is more likely to build up meaningful employment-based pensions at retirement. The coverage rate for these 56 million employees reached 70 percent in May 1983.

Many covered workers, whether or not they are in the "ERISA" workforce, expect to receive benefits at retirement. Of the 50 million covered nonagricultural wage and salary workers, 22 million or 45 percent said they would be eligible for a pension. Another 6 million, or 13 percent of covered workers, expect to receive a lump-sum distribution from their plan when they leave their job. Employees who expect either type of vested benefit -- a pension or a lump sum distribution - sum to 58 percent of covered workers.

Those workers who comprise the "ERISA" workforce are even more likely to be vested in a pension plan. Of the 38 million covered workers in the "ERISA" workforce, 53 percent expect a pension when they reach retirement. Another 3 million workers expect to receive a lump sum distribution. This boosts the total vesting rate for the "ERISA" work force to 67 percent.

Coverage and Earnings

One of the primary public policy objectives in providing tax advantages to employer-sponsored plans has been to ensure that these benefits reach employees across the income spectrum. Employer-sponsored pensions are focused on workers in the middle of the earnings distribution.

Most studies have noted that the coverage rate increases strongly with earnings. Although the majority of workers in the middle of the earnings distribution are covered under a pension plan, coverage rates increase gradually from 58 percent for those earning between $10,000 and $14,999 to 79 percent for those earning between $20,000 and $25,000. Coverage rates approach 85 percent for those earning $50,000 and over.

Another way to examine the distribution of employees entitled to pension benefits is through statistics on the cumulative distribution of employment and coverage by earnings groups. Nearly 83 percent of all nonagricultural wage and salary workers earn less than $25,000 (table 1). Pension coverage and vesting follow this pattern with 76 percent of covered workers and 70 percent of those vested earning less than $25,000 yearly. This broad base of pension coverage and vesting is frequently obscured when differences in coverage rates between earnings groups are emphasized.

Coverage and Age

Workers are more likely to become vested as they reach retirement age. Among nonagricultural wage and salary workers age 60 to 64, 70 percent in the private sector have vested benefits and 88 percent of government workers are entitled to a pension or a lump sum distribution from their current job. Government workers are much more likely to expect only a lump sum distribution, however. Even among those workers age 60 to 64 years of age, 12 percent of government workers expect to receive only a lump sum distribution compared to 5 percent of employees in the private sector.

TABLE 1

EMPLOYMENT, COVERAGE AND VESTING:
CUMULATIVE DISTRIBUTION
FOR NONAGRICULTURAL WAGE AND SALARY WORKERS
ACROSS EARNINGS GROUPS*, MAY 1983

	Cumulative Distribution across Earnings Groups		
	Employment	Coverage	Vesting
Total Employees (000s)	88,214	49,530	28,708
less than $5,000	12.5	5.1	1.3
less than $10.000	31.6	17.3	8.6
less than $15,000	53.8	39.1	28.5
less than $20,000	70.0	59.0	49.8
less than $25,000	82.8	76.2	70.2
less than $30,000	89.8	85.4	81.2
less than $50,000	98.0	97.1	96.0
Total Earnings	100.0%	100.0%	100.0%

*Percentages exclude 9.0% of employees whose earnings are not reported.

Coverage from previous employment could also increase retirement income. In 1983, 18 percent of the "ERISA" workforce, or about 10 million employees reported coverage under an employer-sponsored pension on an earlier job. About 6.6 million had either cashed out their benefits through a lump-sum distribution or were entitled to retirement benefits.

Over 70 percent of all employees receiving preretirement cash outs spent these distributions instead of saving them (table 2). The uses individuals make of preretirement distributions are strongly affected by the amount of the cash out. Eighty-seven percent of those receiving over $20,000 saved their retirement funds. Only 26 percent of those receiving less than $5,000 added these distributions to their savings. In sum, a substantial portion of benefits provided by employer-sponsored plans before retirement are never translated into retirement income.

WHO IS NOT COVERED BY EMPLOYER-SPONSORED PLANS

Not all workers are covered by an employer-sponsored plan. Noncovered workers can be sorted into five categories (chart 1). Fifteen percent of non-covered workers own their on businesses. These self-employed workers can provide retirement protection for themselves and their employees through Keogh plans and individual retirement accounts. The most frequent explanation for low rates of pension coverage among the self employed is that they reinvest their excess funds in their own businesses.

Three percent of noncovered workers are in agriculture. Their coverage rate is the lowest of all noncovered groups at just over 10 percent. Many agricultural employees are low-wage seasonal workers, employed on more than one farm. They frequently face a complex set of other labor market problems.

Table 2

The Use of Preretirement Lump-Sum Distributions
by Purpose and Amount
(as Reported May 1983)

	Total	less than $5,000	$5,000 - $9,999	$10,000 - $19,999	Over $20,000
TOTAL RECIPIENTS[a] (000's)	6,594	5,533	583	218	154
Percent Distribution[a]	100.0%	84.2%	8.9%	3.3%	2.3%
ALL USES[b]	100.0%	100.0%	100.0%	100.0%	100.0%
<u>Total Saving</u>	<u>32.0%</u>	<u>26.0%</u>	<u>57.6%</u>	<u>78.9%</u>	<u>87.3%</u>
Retirement Program	4.4	2.4	*	*	*
Insurance Annuity	*	*	*	*	*
Housing Purchase	10.1	9.3	12.5	*	*
Other Investment	16.8	14.0	29.9	45.9	*
<u>Total Consumption</u>	<u>71.4%</u>	<u>76.6%</u>	<u>51.9%</u>	<u>42.6%</u>	*
Car Purchase	4.8	4.8	*	*	*
Vacation	3.2	3.1	*	*	*
Other Use	63.4	68.7	40.9	*	*

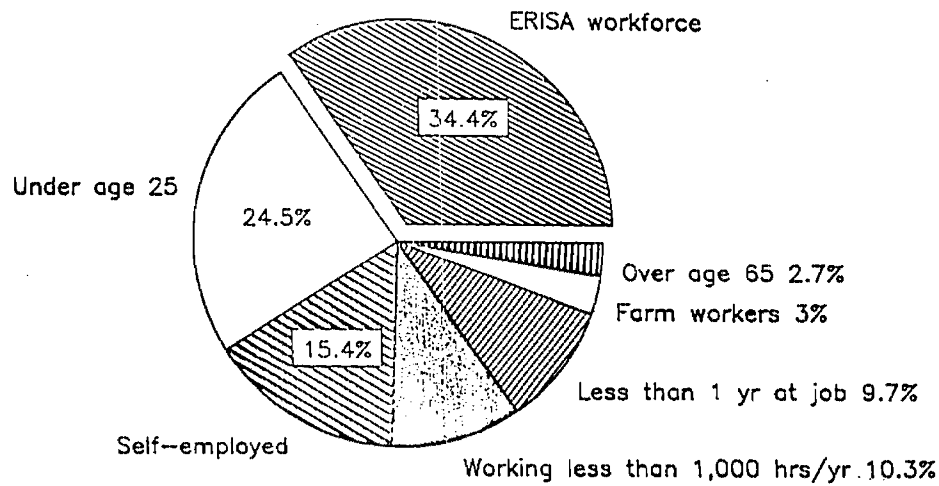
a Recipients by lump sum amount are less than total recipients and percentages are less than 100 percent because of the omission of "don't know" and "no response" to the survey question on the value of the lump-sum distribution.

b Percentages may add to over 100 percent because recipients may have used lump sum distribution in more than one way.

* Number of workers too small for rates to be calculated reliably.

Chart 1

Percent Distribution of Employees Lacking Pension Coverage
Across Employment Categories, May 1983



Note: "ERISA workforce" consists of all employees not included in other categories (employees meeting ERISA participation standards).

Nearly 25 percent of all noncovered workers in 1983 were under 25 years of age. This age group was not subject to ERISA particiption standards according to the 1974 law. Young workers are more likely to have short years of service and to work part-time schedules. EBRI has estimated that lowering the minimum age standard through the Retirement Equity Act will mean that sponsoring employers will have to include an additional 583,000 young employees in their pension plans.[2] Only time will tell whether many more young workers will seek employers who provide pension plans as well.

Workers 65 years of age an older are also a special case; 2.7 percent of all noncovered workers fall in this group. ERISA states that defined benefit plans may exclude all new employees within 5 years of normal retirement age. Furthermore, benefit accruals generally only continue to the normal retirement age (usually age 65).

Workers without coverage who were on the job less than a year or who usually worked less than 1,000 hours accounted for another 20 percent of all noncovered workers. ERISA standards state that pension plans only need credit a year of service to employees who work 1,000 hours or more under the plan.

Those workers meeting all 1983 participation standards made up the remaining 34 percent of all noncovered workers. But, they only represent 16 percent of total employment. A more generous definition of the core of the coverage problem in 1983 would include workers who met all the 1974 ERISA participation standards except for job tenure. Most of these workers will become part of the ERISA work force if they remain on their job for a year. In this case -- which we will call the "near-ERISA" workforce-- the core coverage problem consists of 21 million workers or 21 percent of the labor force.

Characteristics of Noncovered Workers

Noncovered workers in the "near-ERISA" work force differ from those who are covered (table 3). Noncovered workers are much more likely to work in small firms with fewer than 100 employees (68 percent versus 17 percent of covered workers). They are less likely to work under a union contract. Noncovered workers also tend to have lower earnings and shorter job tenure. About 35 percent of noncovered "near-ERISA" workers earn less than $10,000, compared to only 10 percent of all covered workers.

Many of the noncovered workers employed by small firms also have low incomes. Thirty-seven percent of all noncovered workers in firms with fewer than 100 employees earn less than $10,000, and 72 percent of all low-income workers without coverage are employed by small firms. Nonetheless, 7 million workers or 63 percent of noncovered workers in small firms earn $10,000 or more.

The Use of Individual Retirement Accounts

ERISA instituted individual retirement accounts (IRAs) as a means of saving for retirement.[3] Contributions could be made to these accounts on a tax deferred basis until retirement age. About 4.4 percent of eligible noncovered nonagricultural wage and salary workers took advantage of this option in 1978.

The 1981 Economic Recovery Tax Act (ERTA) expanded IRA participation to virtually all workers. While it is not clear whether the wider visibility of IRAs led to greater IRA usage among noncovered workers, their IRA participation

TABLE 3

THE DISTRIBUTION OF COVERED AND NONCOVERED WORKERS
IN THE "NEAR-ERISA" WORKFORCE
AGES 25 THROUGH 64 WORKING 1000 HOURS OR MORE
BY SELECTED CHARACTERISTICS, MAY 1983

	Covered Workers (000's)	Distribution Across Groups	Workers Not Covered[a] (000's)	Distribution Across Groups
FIRM SIZE[b]				
Less than 100 employees	6,215	17.4%	12,352	68.1%
100 to 499 employees	5,545	15.6	2,465	13.6
500 or more employees	23,869	67.0	3,314	18.3
Total	40,702	100.0	20,894	100.0
UNION STATUS				
Union	15,223	38.2	2,163	10.6
Nonunion	24,627	61.8	18,155	89.4
Total	40,702	100.0	20,894	100.0
EARNINGS[d]				
Less than $10,000	4,107	10.4	6,711	34.6
$10,000 to $24,999	24,545	62.1	10,374	53.5
$25,000 or more	10,866	27.5	2,309	11.9
Total	40,702	100.0	20,894	100.0
AGE				
Less than 35	14,588	35.8	9,095	43.5
35 and over	26,133	64.2	11,800	56.5
Total	40,702	100.0	20,894	100.0
HOURS				
Less than 2000	7,525	18.5	5,481	26.2
2000 and over	33,176	81.5	15,413	73.8
Total	40,702	100.0	20,894	100.0
SEX				
Women	16,335	40.1	9,932	47.5
Men	24,367	59.9	10,963	52.5
Total	40,702	100.0	20,894	100.0
TENURE[e]				
Less than 5 years	10,613	28.0	8,328	51.3
5 to 9 years	9,734	25.7	3,958	24.4
Ten years and over	17,518	46.3	3,830	23.6
Total	38,017	100.0	16,116	100.0

[a]Includes workers with no coverage, workers who do not know whether they have coverage and workers with no coverage information reported.

[b]Percentages exclude 12.7 percent of employees for whom firm size is not known.

[c]Includes workers who are not covered by a union contract, workers who do not know whether they are covered under a union contract, and workers with no reported information on unionization.

[d]Percentages exclude 4.4 percent of employees whose earnings are not reported.

[e]Total excludes 11.2 percent of employees who have worked at their current job for less than one year, doesn't include d/r.

SOURCE: Preliminary tabulations of EBRI/HHS May 1983 CPS pension supplement.

participation rate for 1982 rose to 12.3 percent of all noncovered employees. The 17 percent IRA participation rate for all nonfarm employees in 1982 was higher than that for noncovered workers. Lower use rates may simply be a result of lower earnings among noncovered workers. IRA usage among noncovered workers is certainly not higher than average, however.

IRA usage among covered workers may be boosted by the availability of payroll deduction plans and employer-sponsored IRAs. When IRAs are offered at the workplace, more employees take advantage of this option than otherwise. Usage among private nonagricultural wage and salary workers at 27 percent is higher that the 15 percent rate posted by employees whose employer does not offer an IRA.

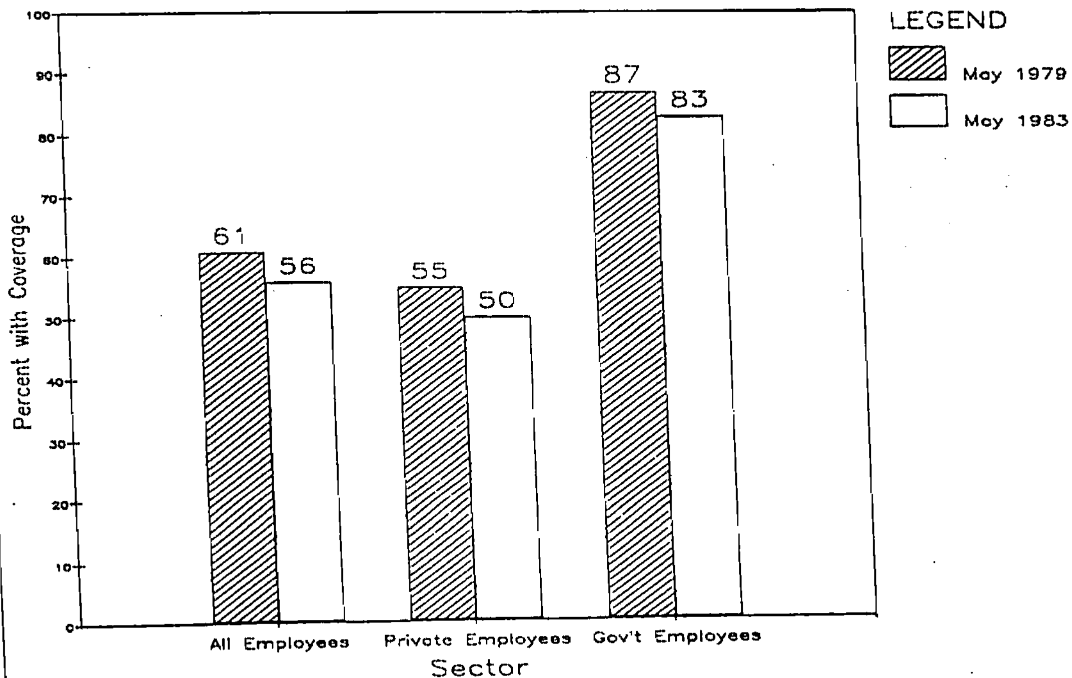
RECENT TRENDS IN EMPLOYER-SPOSORED COVERAGE

Between 1979 and 1983, two trends in coverage are apparent. The first is the overall decline in the coverage rate among nonagricultural wage and salary workers from 61 percent in 1979 to 56 percent in 1983. Declines took place among both private sector and government employees (chart 2). This trend is emerges from other statistics as well. Another monthly measure of the prevalence of pensions among employees was collected by the Census Bureau between 1979 and 1983 as part of the March supplement to the Current Population Survey for all persons employed at any time during the previous year. It indicates gradual reductions in the number of workers who have been participants in a pension plan for each and every year. (Participants are workers whose employer sponsors a plan and who are included in that plan.)

The second trend is the increase in the relative proportion of women

Chart 2

Percent of Non-Farm Workers with Pension Coverage, by Sector, May 1979 and May 1983



among covered workers. Although coverage rates fell for both men and women, declining coverage affected men to a greater extent. The number of women workers grew between 1979 and 1983 while the number of men shrank. As a consequence, 42 percent of covered workers were women in 1983 compared to 39 percent in 1979. The coverage rate for women (52 percent) is still lower than that for men (59 percent).

Industrial Changes and Pension Coverage

The severe 1982 recession and generally poor economic conditions may well have caused declining pension coverage rates between May 1979 and May 1983. Pension coverage rates will fall if employment losses are driven by layoffs in large unionized firms; and postrecessionary pension coverage will rebound. Employment losses resulting from permanent separations in large unionized firms will also lead to falling coverage rates. These losses will not be made up, however. Pension coverage rates may also fall in industries with employment growth if employers postpone establishing new pension plans.

Older industries appear to have been strongly affected by layoffs and permanent separations. The proportion of employees working for large firms decreased and unionization declined. Employers may have postponed establishing new plans in the service sector during the recession causing coverage growth to stagnate.

Declines in employment during the 1982 recession reinforced many of the long-term shifts away from certain sectors of durables manufacturing. Some nondurable goods manufacturing industries, such as chemicals and apparel, also suffered employment losses during the 1982 recession. In many cases the number of covered workers was reduced and coverage rates fell. Employment and pension coverage in the service-producing industries expanded between 1979 and 1983, however. In some sectors, the number of covered workers did not keep pace with employment growth and coverage rates fell. In other sectors, including professional services and financial services, coverage expanded at about the same pace and rates remained relatively constant.

Economic expansion since the May 1983 survey may have produced renewed growth in coverage. But new statistical evidence on plan growth also suggests that coverage may be affected by post-ERISA legislation such as Economic Recovery Tax Act (1981), Tax Equity and Fiscal Responsibility Act (1982), the Tax Reform Act of 1984 and the Retirement Equity Act (1984). The Census Bureau's March statistics on participation for 1984 and 1985 are needed to help determine whether legislative change has reduced coverage growth. These will not be available until late 1985 and late 1986, however, because of interview and processing schedules. Until the evidence proves otherwise, few analysts are forecasting the type of strong growth in pension coverage experienced before 1979.

Changes in Coverage for Women

Continuing concern about the low retirement income received by many older women today was one of the factors which led to the passage of the 1984 Retirement Equity Act. Lower coverage and vesting rates for women were cited as reasons for legislation. Among nonagricultural wage and salary workers in 1983, 59 percent of all men were covered by a pension plan compared to only 52 percent of all women. About 50 percent of all men covered by a pension plan were entitled to benefits at retirement compared to 38 percent of women. While these figures are higher for the "ERISA" workforce, significant gaps in coverage and expected benefit receipt remain. But these gaps have been closing slowly.

The one constant development for women in the workplace over the past 10 years has been that of change. The percentage of women 20 years of age and older working at paid employment grew by nearly 10 percentage points from 43 percent in 1970 to 53 percent in 1983. These gains occurred while the male labor force participation rate gradually declined with increasing college enrollment and earlier retirement. Women make up a larger and larger proportion of the workforce and more women work full-time schedules.

Despite the 1982 recession, women made considerable employment gains between May 1979 and May 1983. An additional 3.3 million women were employed as nonagricultural wage and salary workers. By contrast, male employment edged downward by 278,000 employees in response to the most severe recession since World War II.

Women's employment gains were translated into improvements in coverage and vesting. The number of female wage and salary earners covered by a pension plan increased by 660,000 workers, while the number of women entitled to future retirement benefits jumped by 1.2 million as more women accrued the necessary years of service to qualify for vesting.

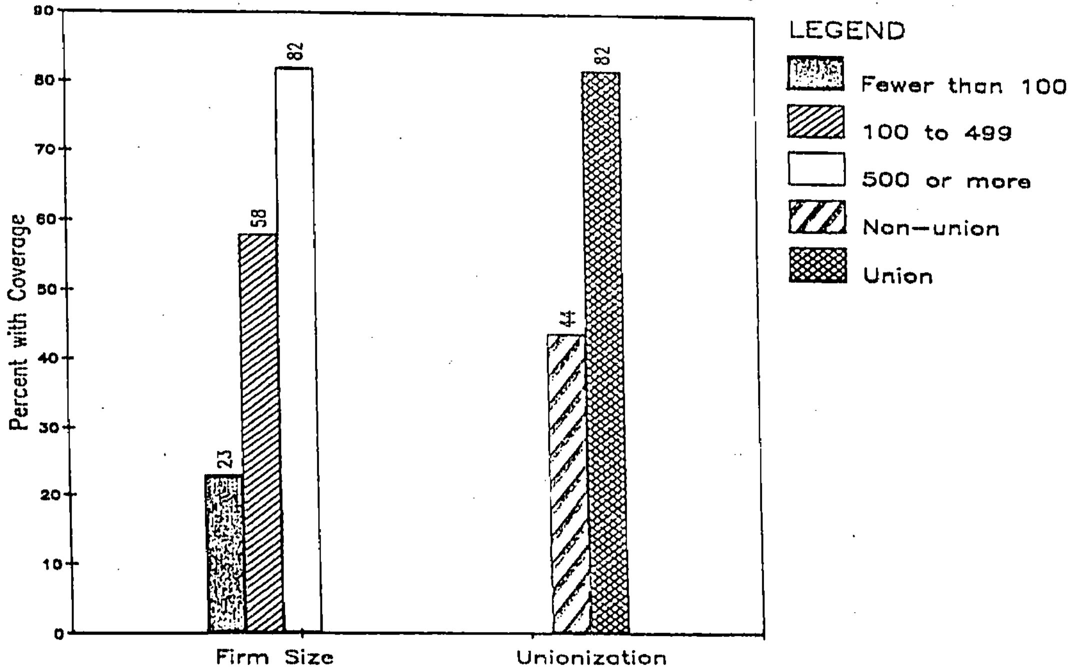
WHAT INFLUENCES PENSION COVERAGE?

Whether an employee has employer-sponsored coverage depends on the characteristics of the workplace and the characteristics of the employee. As we have seen, some workers are more likely than others to be covered by an employer-sponsored plan. A number of statistical techniques are available which show the impact of differences in one factor from the effects of other related factors. We have used one technique called "analysis of variance" to determine which characteristics are the most important determinants of differences in pension coverage among private sector employees. According to a specification which determines the independent effect of each set of characteristics, those factors related to ERISA participation standards--age, hours of work and job tenure--were found to explain 16 percent of the variation in pension coverage among employees. Differences in wage rates were found to explain 16 percent of the variation and industry differences explained 17 percent.

By contrast, firm size combined with the effect of unionization at different firm size explains 52 percent of the variation in coverage. Eighty-two percent of private sector employees working for firms with more than 500 employees have pension coverage. This drops to 23 percent in small firms employing 99 or fewer workers. The coverage rate for private sector employees under a collective bargaining agreement is 82 percent; that for nonunionized employees is 44 percent (chart 3).

Small, nonunionized firms are less likely to establish pension plans. Simple statistics also can be used to demonstrate this fact as well. Less than 10 percent of workers in firms with less than 100 employees are unionized. Seventy-two percent of unionized workers in firms with less than 500 employees are covered by a pension plan, compared to only 28 percent of nonunion workers in such firms. The difference in coverage between unionized and nonunionized firms diminishes as the size of the firm increases. In the

Chart 3
Percent of Non-Farm Private Employees with Pension Coverage, by Firm Size and Unionization, May 1983



case of larger corporations, the difference is quite small. The most likely explanation for the effect of unionization on coverage is the ability of multiemployer plans to bring economies of scale into pension investment and administration.

The Potential Effect of Policy Changes

EBRI statistics suggest that if policies could be devised which would increase the extent of coverage among small firms, many more workers would qualify for pension benefits at retirement. If firms with fewer than 100 workers were as likely to have a pension plan as firms with 100 to 500 workers, 7.6 million more employees would be covered; of these 3.6 million would be vested (table 4). If firms with 100 to 500 employees were as likely to have a pension plan as firms with over 500 workers, there would be 2.2 million more covered workers and 837,000 more vested workers. These estimates are based on ERISA participation standards before the Retirement Equity Act. REA changes in participation would increase vesting in small plans even more as some workers under age 25 would be vested.

If increased coverage could be obtained it would be a more effective way to increase pension receipt than many other policy options being discussed. For instance, increasing coverage among plans with fewer than 100 workers would add 92.7 percent more vested workers than five-year vesting. Five-year vesting would include more additional vested workers than a combination of expanded participation options including the recently enacted Retirement Equity Act, proposals to include more part-time workers and proposals to include older workers within 5 years of retirement. If the likelihood of

Table 4

Estimated Changes in Coverage, Participation and Vesting
if Smaller Firms Provided Coverage
to the Same Extent as Larger Firms
1985

If Firms with Fewer Than 100 Workers Had[a] Coverage Rates of Firms with 100 to 500 Workers	
Increased numbers of Older Workers (000's)	
Covered Workers	7,575
Participants	4,738
Vested Workers	3,575
If Firms with 100 to 500 Workers Had[b] Coverage Rates of Firms with over 500 Workers	
Increased numbers of[d] Older Workers (000's)	
Covered Workers	2,248
Participants	1,298
Vested Workers	837

[a]Estimates of increase in coverage for firms with less than 100 workers based on a simulated increase in the rate of covered workers to employees from 28.8 to 51.0 percent. The ratio of participants to covered workers declines from 75.5 to 69.9 percent in the simulation and ratio of vested workers to participants increases from 74.2 to 74.7 percent. These changes are applied to imputed data on pension status to best represent actual numbers of participants and vested workers in 1983. These figures are brought forward to 1985 by assuming a 10.0 percent gain in employment over the 1983 simulation.

[b]Estimates of increase in coverage for firms with 100 to 500 workers based on a simulated increase in the rate of covered workers to employees from 62.6 to 82.9 percent. The ratio of participants to covered workers declines from 74.8 to 70.6 percent in the simulation and ratio of vested workers to participants declines from 72.6 to 71.0 percent. These changes are applied to imputed data on pension status to best represent actual numbers of participants and vested workers in 1983. These figures are brought forward to 1985 by assuming a 10.0 percent gain in employment over the 1983 simulation.

coverage among firms with 100 to 500 workers could increase to that of the largest firms, the number of new vested workers would virtually equal the effect of a shift to seven-year vesting.

This does not imply that issues other than coverage are not important. There has been recent policy interest in other areas covered by ERISA such as post-65 accruals,[5] vesting standards[6] and pension integration. Nonetheless, effective policy to improve coverage would increase pension protection to the greatest extent. The issue, of course, is how could even a partial shift be accomplished.

IRAs were the first suggestion. They have not substantially increased coverage among noncovered workers. Another suggested remedy to increase coverage in small firms was the mandatory pension system proposal made by the President's Commission on Pension Policy. According to that proposal all employers would have to contribute a minimum of 3 percent of payroll onbehalf of all employees over the age of 25 with one year of service and 1,000 hours of employment. Objections to this proposal ranged from concerns about market regulation and individual choice to concerns about the potential negative effects on the economy, in general, and on small businesses in particular. Additionally, it was pointed out that this would only have helped the 34.4 percent of noncovered persons residing in the ERISA workforce (see Chart 1).

The challenge is to devise policies to encourage expanded coverage without producing adverse indirect effects on workers or firms. The Congress will have to decide what level of retirement program coverage it thinks is desirable, and feasible, and at what price to employers, employees, and the federal government.

NOTES

1. See "New Survey Findings on Pension Coverage and Benefit Entitlement, EBRI Issue Brief 33, August 1984.

2. See "Impact of Retirement Equity Act," EBRI Issue Brief 39, February 1985.

3. See "Individual Retirement Accounts: Characteristics and Policy Implications," EBRI Issue Brief 32, July 1984.

4. Scale economies in multiemployer plans are explored in Olivia S. Mitchell and Emily S. Andrews, "Scale Economies in Private Multi-Employer Pension Systems," Industrial and Labor Relations Review 34 (July 1981): 522-530.

5. See "Pension Accruals for Older Workers," EBRI Issue Brief 35, October 1984.

6. A more extensive discussion of the impact of various policy proposals, including quicker vesting, will be found in Emily S. Andrews, The Changing Profile of Pensions in America (Washington, D.C.: EBRI, forthcoming 1985).

Attachment 2

ITEM 5

FEBRUARY 1985 NUMBER THIRTY-NINE

New participation and vesting standards affect less than 1 percent of the work force—adding 583,000 new participants and 325,000 new vested workers.

Impact of Retirement Equity Act

The 1984 Retirement Equity Act (REA) aimed to improve pension equity by lowering the age of participation, improving spousal and survivor benefits, and liberalizing break-in-service rules, effective January 1, 1985.

Using a simulation model and new survey data, this *Issue Brief* provides the first nationwide estimates on the number of new pension plan participants and vested workers likely to result from REA. EBRI estimates that REA will add around 583,000 new participants and 325,000 new vested workers in 1985. Slightly more than half of all new vested workers are expected to be men. In all, the number of workers affected by the new participation and vesting standards is less than 1 percent of the nation's civilian work force.

The actuarial costs of lowering the participation and vesting standards are estimated not to exceed $233 million, although increased administrative costs could more than double that cost.

The new law creates the potential for the percentage of widows receiving private pensions to climb to the rates for married men. Depending on trends in divorce settlements, REA's divorce provisions could also result in higher pension income for divorced women and lower benefits for their former spouses. Around 44,000 survivors will become entitled to preretirement survivor benefits in 1985 with first-year benefits from this provision ranging from $29 million to $72 million. The full effects of REA on spouses, surviving spouses, and divorced spouses is still extremely uncertain and hinges on the future behavior of individuals and couples.

Introduction

The 1984 Retirement Equity Act (Public Law 98-612) has been widely hailed by groups concerned with women's rights as a major breakthrough in pension equity. It lowered the age of participation, improved spousal and survivor benefits, and liberalized break-in-service rules. The new provisions became effective January 1, 1985.

This *Issue Brief* estimates numbers of new pension plan participants and vested workers that result from the new legislation, using simulations for employed workers in 1983 and bringing these estimates forward to 1985. It gives illustrative ranges of first-year plan costs for its key provisions.[1] The impact of every provision of the Retirement Equity Act (REA) cannot be quantified. The break-in-service standards, for example, do not lend themselves to nationwide estimation, because no nationwide data are available on employees who return to their jobs after time away. For other provisions affecting spouses, divorced spouses, and surviving spouses of participants, where similar estimation problems exist, relevant facts and figures are provided. Special studies would be required for a fuller treatment.

Changes in Participation Standards Under ERISA

When the Employee Retirement Income Security Act (ERISA) was enacted in 1974, employers did not have to include all of their employees in their pension plans unless specific conditions of employment were met. For instance, employers could wait one year before new employees had to be offered the opportunity to participate in the firm's plan. A year of service was usually defined as 1,000 hours during the initial 12-month period of employment. If the employee were under age 25, the waiting period could be extended until the worker reached age 25. Once the worker began participating in the pension plan, service between ages 22 and 25 had to be counted for purposes of vesting.

On the other end of the age spectrum, defined benefit plans could exclude employees who were within five years of normal retirement at the time of starting their employment. This provision was intended to avoid discouraging employers from hiring older employees because of pension funding costs. Furthermore, employers were not required to provide pension accruals for their employees who reach the plan's normal retirement age, most commonly age 65, and who wish to continue working.

[1] This *Issue Brief* draws heavily from a forthcoming book by Emily S. Andrews, *The Changing Profile of Pensions in America* (Washington, DC: EBRI, 1985).

The original 1974 ERISA participation requirements include employees age 25-64, with at least 1,000 hours of service and one or more years of tenure with their current employer. These were the ERISA standards in effect at the time the May 1983 EBRI/HHS Current Population Survey (CPS) pension supplement data were collected.[2] Since then, REA liberalized a number of the original participation provisions. By using the 1983 EBRI/HHS CPS and applying changes derived from a model developed to simulate the probabilities of coverage, participation, and vesting, one can estimate the initial effects of changes in ERISA participation provisions for employed workers.

The 1984 Retirement Equity Act has been widely hailed by groups concerned with women's rights as a major breakthrough in pension equity.

Effect of the Retirement Equity Act on Participation and Vesting

According to the 1983 Bureau of Labor Statistics (BLS) survey of medium and large firms,[3] 39 percent of all workers had a minimum-age requirement of 25 years as permitted under the original provisions of ERISA. Plans with such minimum-age provisions excluded young workers from accruing benefits under their pension plans. Although younger workers average very short tenure on their initial jobs, some maintain employment with their first or second employer.

REA was intended to prevent benefit losses for young workers with stable employment. Many felt that women, in particular, lost benefit entitlement through ERISA's minimum-age standards, because women are more likely to have nontraditional patterns of labor force participation. As a consequence, ERISA was amended through REA to reduce the age of plan participation from 25 to 21 and that of vesting from 22 to

[2] See "New Survey Findings on Pension Coverage and Benefit Entitlement," *EBRI Issue Brief* 33 (August 1984) for a more detailed description of this survey.

[3] See U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in Medium and Large Firms, 1983* Bulletin 2213 (Washington, DC: U.S. Government Printing Office, August 1984) for a description of that survey.

18. The hope was that women would be able to accrue pension benefits during their years of early employment before career interruptions for child care. The legislation was also expected to have a greater impact on women, because 50 percent of all full-time pension plan participants in technical and clerical occupations (predominantly women) were subject to minimum-age requirements under their plans.

EBRI's preliminary analysis of the effects of REA, conducted prior to the enactment of the legislation, suggested that relatively few employees would be affected.[4] The bill became law in August 1984 before further analysis using the May 1983 EBRI/HHS CPS pension supplement could be provided. Post-enactment evaluation now suggests that the benefits of REA are more modest than originally anticipated.

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REA does not offer pension plan participation to the 10.5 percent of all employees age 21-24 who work fewer than 1,000 hours yearly and the 32.3 percent of them on the job less than a year. Also, ERISA standards only apply to private-sector employees. The effect of ERISA minimum-age standards is evident among private-sector nonagricultural employees working over 1,000 hours: the private pension plan participation rate for covered workers age 21-24, at 66 percent, is considerably lower than the 90-percent participation rate for covered workers age 25-64.

To estimate the numbers of workers likely to benefit from changes in ERISA provisions, EBRI developed a model to simulate the probabilities of coverage, participation, and vesting for particular subgroups of workers under specified changes in legislation. In the case of REA, the model simulates changes in the participation rate and vesting rate of workers age 21-24, taking into account all characteristics that affect these rates and their relative distribution among younger workers.[5]

The simulation model indicates that if REA had been passed and become effective in 1983, it would have added 530,000 young participants, nearly 300,000 of whom would have been entitled to vested benefits (table 1). These 530,000 workers represent only 5.6 percent of the work force of 9.5 million private-sector nonagricultural wage and salary workers age 21-25. Newly vested workers represent only 3.1 percent of all such young workers. In other words, the gains in pension entitlement, while real, provided increased protection for a relatively small proportion of young workers.

New participants under REA are more likely to be women than men, as the participation rate (the ratio of participants to covered workers) for young women is improved relatively more. This finding is consistent with the evidence noted earlier, which suggests that more young women are working in firms with minimum-age requirements. In terms of vesting, however, there is a somewhat greater proportion of men among the nearly 300,000 workers who would have been newly entitled to benefits if REA had been effective in 1983.

Employment expanded by 5.6 percent between May 1983 and May 1984 as the economy recovered strongly from the 1982 recession. Consequently, 1983 estimates of the effect of REA are adjusted upward by 5.6 percent for 1984. A second estimate for 1985 assumes a 10 percent employment growth since the 1983 simulation. The number of young participants affected by REA in 1985 will reach about 583,000 and new vested workers will reach around 325,000. In all, the workers affected by REA represent less than 1 percent of a total labor force of more than 100 million.

Cost of REA Participation and Vesting Provisions

It is difficult to make a precise estimate of the actuarial cost of REA to employers because of the diversity of plan provisions, differences in employee age distributions within firms, and differences in the ways plans schedule costs into their contributions. For instance, firms with few young workers would need to make little provision for REA beyond one-time changes in plan documents. Plans with many young workers would need to increase contributions considerably to cover actuarial and administrative costs. Actuarial costs for young workers in defined benefit plans would be lower than those for defined contribution plans with similar overall contribution rates.

[4] See "Women and Pensions, Part II: Implications of Proposals for Reform," *EBRI Issue Brief* 20 (July 1983) for an earlier upper-bound estimate.

[5] In addition to age, these characteristics include such factors as firm size, unionization, industry, hours, tenure, and wages. See Andrews, *Changing Profile*, Statistical Appendix (forthcoming), for a fuller description of the model.

Table 1
Estimated Effect of REA
Changes in Participation, Vesting, and Costs[a]

	1983[b]	1984[c]	1985[d]
Changes in Participation/ Vesting	(in thousands of workers age 21-24)		
Increased numbers of			
Participants			
Male	242	256	267
Female	288	304	316
Total	530	560	583
Vested workers			
Male	152	161	167
Female	143	151	158
Total	296	312	325
Illustrative Nationwide Actuarial Cost Estimates[e]	(in millions of 1983 dollars)		
At average annual cost of $200 per participant[f]	$106	$112	$117
At average annual cost of $400 per participant[f]	$212	$224	$233

Source: Preliminary EBRI estimates based on May 1983 EBRI/HHS CPS pension supplement and estimates of actuarial costs by age by Anna M. Rappaport and Malcolm M. Morrison.

[a] Estimates use imputed data on pension status.
[b] Estimates of Retirement Equity Act provisions based on a simulated increase in the ratio of participants to covered workers from 54.5 to 66.5 percent for women and from 68.0 to 76.6 percent for men. The simulated ratio of vested workers to participants declines from 50.9 to 50.7 percent for women and increases from 53.0 to 54.3 for men.
[c] Estimate is 5.6 percent higher than 1983 simulation.
[d] Estimate is 10.0 percent higher than 1983 simulation.
[e] Does not include administrative costs.
[f] Derived from Appendix Exhibits A-1, A-6, and A-11, Anna M. Rappaport and Malcolm M. Morrison, *The Costs of Employing Older Workers*, An Information Paper Prepared for Use by the U.S. Senate Special Committee on Aging (Washington, DC: U.S. Government Printing Office, 1984). Based on approximate pension costs for participants less than 30 years of age in defined benefit plans earning an average of $17,500. Employer assumed to contribute 5 percent and 10 percent of total salary costs. Dollar values equal the number of participants affected times the per-participant cost.

Illustrative actuarial cost estimates can be developed based on the numbers of participants affected to provide a reasonable range of costs that may be incurred because of REA's adjustment to participation and vesting ages. These estimates are based on approximate dollar contributions required to fund a defined benefit plan for specific age groups at specific salary levels under alternative total employer contribution rates.[6] The most likely range of actuarial costs is probably represented by employer contributions of 5-10 percent of salary. For 1985, this produces a range of actuarial costs from $117 million to $233 million. Even the higher estimate represents less than 0.5 percent of total annual employer contributions to private pension plans.

Administrative costs could more than double this actuarial estimate, however. These costs may be extensive. Young workers with high turnover rates contribute to high recordkeeping expenses.

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Dislocations caused by REA may depend primarily on the impact of administrative costs, as the actuarial costs of benefit accrual are limited and the number of the workers affected is small.

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Labor market adjustments are likely to take place as some employers realign their cost structures for REA provisions. Firms hiring relatively few young workers will probably make little or no adjustment. Others may hire fewer workers under age 25 or provide smaller wage increases to make up for the increased compensation costs. Some firms might switch from defined contribution plans to defined benefit plans, which have lower relative costs for younger workers. In the most extreme case, employers might terminate their plans if they hire many young employees; some employers suggest this may be happening.

These adjustments are all likely to occur to some degree, lowering the direct costs of REA and reducing future retirement benefits as well. Dislocations caused by REA may depend primarily on the impact of administrative costs, as the actuarial costs of benefit accrual are limited and the number of the workers affected is small.

[6] Derived from Appendix Exhibits A-1, A-6, and A-11, in Anna M. Rappaport and Malcolm M. Morrison, *The Costs of Employing Older Workers*, An Information Paper Prepared for Use by the U.S. Senate Special Committee on Aging (Washington, DC: U.S. Government Printing Office, 1984).

A policy issue gaining greater prominence as a result of REA is the debate about the treatment of lump-sum distributions. REA increases the amount from $1,750 to $3,500 that a defined benefit plan may opt to distribute to a departing participant in a lump sum. The majority of benefit accruals for workers age 21-24 will be less than this new limit.[7] The use of lump-sum payments for current consumption, instead of retirement saving, will erode the efficacy of REA as a means of providing future retirement income to women with career interruptions.[8]

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Overall Effects of Changing Participation and Accrual Standards

Young workers would be mistaken if they expected that early benefit accruals alone would provide a meaningful pension at retirement without continued participation under a pension plan. The new participation and vesting standards of REA are likely to provide young workers relatively limited retirement income. Workers who leave defined benefit plans at age 25 are entitled to benefits at retirement based on their present wages. Furthermore, a large proportion of these workers will consume the lump sums they receive upon termination of employment. Additional benefit entitlement for employees working 500 to 1,000 hours is also likely to be limited because of short tenure and low earnings.

[7] See *Analysis of Alternative Vesting ... quirements for Private Pensions* (Washington DC: EBRI, 1980), table 2.

[8] See G. Lawrence Atkins, "Distributions from Employer-Sponsored Pension Plans at Termination: Implications for Retirement Income and Tax Policy" (Ph.D. dissertation, Brandeis University, 1984).

◆ New Benefits for Widows and Spouses

One frequently cited failing of our retirement income system is the persistently high poverty rate found among older women living alone. Although the reasons for low income among aged widows are only partially understood, some policymakers felt that a restructuring of ERISA would improve retirement income adequacy in the future. As a consequence, REA amended ERISA to help provide greater pension benefits for widows and divorced wives. Its provisions focus on three areas: joint and survivor benefits, preretirement survivor benefits, and benefit payments to divorced spouses.

Quantitative information about the potential impact of these new provisions remains scanty. First, direct information about the use of many of the provisions is not available. For example, there are no figures on the prevalence of preretirement survivor elections. Second, little is known about the extent to which employees elect to provide survivor benefits for their spouses before or after ERISA. In addition, there are no economic studies on the way in which financial divorce settlements are reached. More information is available on whether divorce settlements will be adhered to than on the way couples decide to split their income and assets. In part, no cost-benefit analysis has been undertaken in these areas because many of these issues involve behavior outside the realm of traditional economics. Similarly, some REA provisions are of little actuarial interest since plans may not be faced with additional actuarial costs. Nonetheless, information on income and benefit receipt from the March 1983 Current Population Survey[9] indicates the potential impor-

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[9] These data have been added to the May 1983 EBRI/HHS CPS pension supplement.

tance of these provisions to widows and spouses in the near future.

More Secure Joint and Survivor Benefits

In our society, women tend to outlive men. Average life expectancy for men born in 1984 is 71.2 years compared to 78.6 years for women. Along with the general tendency for women to marry somewhat older men, most married women can expect to be widows for a number of years. Given these facts, couples ought to plan for this contingency.

Before ERISA, most plans granted a monthly pension benefit for the life of the retired worker, alone, as the normal option. If retirees wanted their pensions to be paid to their spouses after their death, they had to take the initiative to notify the plan to that effect.

ERISA provided that the joint and survivor annuity, which pays pension benefits to the retired worker's surviving spouse, would be the normal retirement payment for married couples. The surviving spouse's annuity had to be at least one-half of the annuity payable to the participant during the couple's remaining lifetime together. Such benefits are generally subject to an actuarial reduction lowering the monthly income of the couple relative to that which the participant would have received had the single-life option been selected. Under ERISA, the participating employee could still decide against the joint and survivor annuity in favor of a single-life pension benefit, which would cease upon the participant's death.

A plan participant could want to select a single-life benefit for many reasons that would not detract from the financial security of either spouse. For instance, a woman might prefer such an arrangement on the supposition that she is likely to outlive her husband, and, even if she did not do so, her husband would have sufficient income on his own after her death. Alternatively, a husband might select a single-life option having provided sufficient life insurance to pay for an annuity for his wife upon his death. Other examples can easily be imagined depending upon the financial circumstances of the couple.

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Many felt that despite ERISA, male pension plan participants, to the detriment of their wives, tended to choose the higher-paying single-life annuity, which would cease at their death. Some hypothesized that because the higher benefit looked more desirable, husbands were willing to gamble on their own mortality. With the growing recognition that marriage is a partnership, REA sought to bring both spouses into the decisionmaking process by requiring that both of them consent to the waiver of the joint and survivor annuity. Since this provision affects both retirement and preretirement survivor's annuities, the potential effect on spouses old enough for Social Security retirement benefits will be the first focus of discussion here.

Table 2
Some Facts and Figures on Pension Receipt
for Men and Women Age 62 and Older, 1982

	Married Men	Never Married Women	Divorced Women	Widowed Women	Married Women
Population (000's)	10,435	949	848	8,420	8,112
Number Receiving Own Pension Income (000's) (as worker or survivor)	2,816	220	135	948	495
Percent Receiving Own Pension Income (as worker or survivor)	27.0	23.2	16.0	11.3	6.1
Average Pension Benefit	$4,811	$3,668	$2,473	$2,949	$2,763

Source: EBRI tabulations of March 1983 Current Population Survey.

Although we have no nationwide data directly measuring the extent to which married participants have selected the joint and survivor pension option, March 1983 Current Population Survey data provide an indirect means to evaluate its use and to provide estimates of the potential of REA to increase pension protection for women. Twenty-seven percent of married men age 62 and over received income from private pensions in 1982 (table 2).[10] This represents a rough estimate of the percentage of widows who could receive survivor's benefits if every couple were to select that option.

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In 1982, twenty-seven percent of married men age 62 and over received income from private pensions, but only 11.3 percent of widows age 62 and older received pension benefits from private plans.

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In 1982, only 11.3 percent of widows age 62 and older received pension benefits from private plans. Of course, some of these women were widowed before their husband's retirement and would not have been eligible for benefits under ERISA or pre-ERISA standards. Furthermore, over 48 percent of elderly widows are 75 years of age or older. The prevalence of pension receipt among their husbands was likely to be lower than for younger groups of retirees.

If REA had been in effect for these elderly widows when their husbands first began receiving pensions, the rate of pension receipt might have increased by 16 percent—the difference between the 27-percent receipt rate for elderly married men and the 11-percent receipt rate for elderly widows. An upper-bound estimate can be constructed under the assumption that no widows receive pensions as both retired workers and survivors. About 6 percent of all married women age 62 and over receive their own pensions (table 2). If widows receive their own pensions in similar proportions, over half of all widows receive benefits on their own and less than half receive pensions as survivors. Consequently, complete selection of the joint and survivor option would increase the rate of pension receipt among elderly widows by 22 percent—the difference between the 27-percent receipt rate for elderly married men and the 5-percent survivor-only estimate for widows.

On the one hand, these rough estimates suggest that if REA had been in effect earlier, an additional 1.3 million to 2.0 million widows might be receiving pensions through joint and survivor benefits. On the other hand, if husbands acted with full knowledge of their pension options and in full cooperation with their wives, both before and after ERISA, REA would not have added a single pension dollar to widows' benefits. Most likely, actual experience will lie between these extremes. More pensions will probably be paid on a joint and survivor basis than before.

The effect of the joint and survivor option on average pension benefit receipt is suggested by comparing pensions received by married men to those received by widows. Widows received pensions of just under $3,000 in 1982, about 60 percent of those earned by married men. Men with relatively high pensions appear most likely to have selected the joint and survivor option.[11] If joint and survivor benefits had been more widespread, widows without benefits would have received additional retirement income, but their benefits would not have been as high. Although REA is intended to provide benefits to more older widows in the future, it cannot improve the situation of those widows who lost pension benefits because of earlier decisions about joint and survivor use.

Preretirement Survivor Annuities

Another goal of REA was to ensure benefits to spouses of plan participants who were widowed before normal retirement age. Death rates of men and women differ substantially in middle age, resulting in many widows.[12] In particular, homemakers widowed in their late 50s may face a significant drop in income, since they do not qualify for Social Security young survivor's benefits if their children are over age 16 (previously age 18) or for Social Security retirement benefits if they are under age 62. Furthermore, widows of vested workers could lose all rights to substantial vested benefits that they had counted on for income in retirement.

[10] This figure probably underestimates potential pension receipt, as some older men have not yet retired. Also, surveys of individuals tend to undercount pension recipients. A measure of the undercount is found in Daniel Radner, "Distribution of Family Income: Improved Estimates," *Social Security Bulletin*, July 1982.

[11] This finding is reinforced because the benefits of married men are likely to be relatively high compared to the benefits of widowed women. Married men are relatively younger and have higher pension benefits than older retired men. Widows are relatively older and are likely to have had the value of their pensions eroded by inflation.

[12] The death rate for men age 45-54 is 761 per 100,000 compared to a rate for women of 408 per 100,000. Similarly, the death rate for men age 55-64 climbs to 1,784 per 100,000, whereas that for women only rises to 942 per 100,000.

As a response to these concerns, REA also amended ERISA to automatically provide preretirement survivor benefits, payable at the plan's earliest retirement date, to the spouse of a vested participant who died before retirement. Unless both spouses waive the preretirement survivor option, benefits will be provided to the surviving spouse whether or not the participant retired or had achieved eligibility under early or normal retirement.

Previously, plan participants had to elect a preretirement survivor's benefit, if and when early retirement benefits were available. Furthermore, preretirement survivor benefits were only available after the participant was eligible for early retirement. Under REA, all spouses of vested participants are eligible for preretirement survivor's benefits in one of two forms: (1) as an annuity payable at the earliest qualifying retirement age under the plan or (2) as a mandatory lump-sum distribution if total accrued benefits are less than $3,500.

The proportion of widows receiving pension benefits prior to REA on the basis of a preretirement survivor annuity is not known. The closest proxy for this figure is the 12.7 percent of widows age 55-61 who are receiving private pension income (table 3). Of course, some widows will have remarried, while others who received preretirement survivor benefits will be over age 61. Some women may be receiving early retirement pensions on their own behalf.

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REA also amended ERISA to automatically provide preretirement survivor benefits, payable at the plan's earliest retirement date, to the spouse of a vested participant who died before retirement.

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Estimates of the proportion of married men whose wives are eligible for preretirement survivor benefits upon their early death also provide only a partial picture of the potential impact of the change in ERISA. Although the 1983 BLS survey of medium and large firms indicates that 97 percent of all participants are in plans with early retirement provisions, age and service conditions vary widely. By far the greatest number of participants (61 percent) are covered by plans specifying an early retirement age of 55. Nearly four out of five of these participants can retire with ten years of service or less. Although preretirement survivor benefits under REA will be paid to the widows of all vested workers (unless they opt out of this benefit), some widows will be eligible for benefits much earlier than others.

Table 3
Facts and Figures on Preretirement Benefits and Entitlement, 1982

	Widows Age[a] 55-61 (000's)	Married Men[a] Age 45-61 (000's)
Total	1,215	15,351
Entitled to Pensions	154[b]	4,808[c]
As percent of total	12.7	31.3

Source: EBRI tabulations of March 1983 Current Population Survey.

[a] Widows age 55–61 are most likely to actually receive preretirement spousal benefits. Deaths among married men age 45–61 are most likely to lead to preretirement spousal benefits for future widows age 55–61.

[b] Widows actually receiving pensions.

[c] Men currently working and entitled to pensions.

The proportion of married men entitled to pension benefits (31.3 percent) provides a rough estimate of the proportion of future widows who will be eligible for this benefit. This figure is 18.6 percentage points higher than the percentage of widows of approximately early retirement age who currently receive pensions. Although this evidence is sketchy, REA seems to provide the potential for improved benefit receipt for future generations of widows.[13]

Applying death rates to the number of vested married workers by age in 1983 provides an estimate of the number of widows and widowers who would have been available for preretirement survivor annuities in that year. Assuming that the number of vested workers grew in proportion to nonagricultural employment, about 104,000 workers would be eligible for benefits in 1985 if the provision were in effect the entire year (table 4). About 89,000 eligible survivors for the full year are widows and an additional 15,000 are widowers. This difference in the number of men and women who will receive preretirement death benefits (unless they opt out of the option) is due to relatively lower coverage and vesting rates among female workers and relatively higher male death rates. The value of this benefit for young widowers will increase as more and more families depend on two incomes. Since the preretirement survivor annuity provision will be phased in this August, only around 42 percent of the 104,000 eligible workers (44,000 new widows and widowers) will actually be affected by the legislation in 1985.

[13] The differences in the rate of pension receipt for widows and the rate of benefit entitlement for married men (table 3) is roughly equivalent to the difference between pension receipt rates for elderly married men and widows (table 2). These similarities tend to support the hypothesis that the maximum impact of the preretirement survivor provisions may be substantial.

These estimates assume that no new widows and widowers would have been eligible for preretirement survivor benefits before REA. However, nearly half of vested worker deaths before age 65 occur in the 55-64 age group. Some of these workers would have already provided preretirement survivor benefits for their spouses. Under REA, a worker can opt out of the preretirement survivor option at age 35. This decision can be changed at early retirement, however. Although couples may have reasons to opt out of joint and survivor benefits when the worker retires, it is hard to discern a reason for opting out before retirement, particularly because two signatures are required.

Table 4
Estimated Effect of REA
Changes in Preretirement Survivor Benefits[a]

	1983[b]	1984[c]	1985[d]
Survivors of Vested Workers Who Die Before Normal Retirement Age	(in thousands of workers)		
Male	14	14	15
Female	81	86	89
Total	95	100	104
Illustrative Preretirement Survivor Benefits[e]	(in millions of 1983 dollars)		
Annual benefit payments at $10,000 salary[f]			
First-year benefits[g]	$ 63	$ 66	$ 69
Mature system benefits[h]	$ 97	$102	$107
Annual benefit payments at $25,000 salary[f]			
First-year benefits[g]	$156	$165	$172
Mature system benefits[h]	$243	$256	$267

Source: Preliminary EBRI estimates based on May 1983 EBRI/HHS CPS pension supplement, U.S. National Center for Health Statistics death rates, and estimates of annual spouses benefits under various assumptions provided by William M. Mercer, Incorporated.

[a] Estimates use imputed data on pension status.
[b] Number of widows and widowers based on numbers of married workers times age-specific death rates.
[c] Estimate is 5.6 percent higher than 1983 simulation.
[d] Estimate is 10.0 percent higher than 1983 simulation.
[e] Does not include administrative costs.
[f] Per-beneficiary payments estimated using figures on annual spouse's benefits from Appendix I, table III (by William M. Mercer, Incorporated) in statement of Dallas L. Salisbury submitted to the U.S. House of Representatives, Committee on Education and Labor, Subcommittee on Labor-Management Relations, for its September 29, 1983 hearing on "Women's Pension Equity."
[g] First-year benefits represent payments for early retirement benefits to spouses immediately eligible.
[h] Mature system benefits represent payments for first-year benefits and payments to all persons widowed at younger ages who have now reached age 55-65 and have become eligible for early retirement benefits in that year.

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REA seems to provide the potential for improved benefit receipt for future generations of widows.

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A range of illustrative annual estimates of benefit costs has been developed based on the number of surviving spouses of vested workers who died before retirement age. One estimate assumes low average salaries of $10,000 and the other assumes high average salaries of $25,000.[14] Two types of benefit estimates are provided: (1) first-year benefits payable immediately to widows and widowers whose spouses would have been eligible for early retirement; and (2) mature system benefits, if REA provisions had been in effect over a longer period of time. These benefits include survivors widowed at preretirement ages reaching benefit eligibility according to early retirement standards.[15]

If REA provisions had been in place in 1983, mature system benefits would have cost between $97 million and $243 million. This represents less than 0.5 percent of contributions

[14] Estimates are based on analysis by William M. Mercer, Incorporated, included in a statement by Dallas L. Salisbury (Appendix I, table III, column 2) submitted to the U.S. House of Representatives, Committee on Education and Labor, Subcommittee on Labor-Management Relations, for its hearing on "Women's Pension Equity," September 29, 1983 (Washington, DC: EBRI, testimony T-22).

[15] Both figures are upper-bound estimates. No reductions are assumed for benefits paid at early retirement. Furthermore, the current age distribution of eligible survivors is used to estimate mature system costs. The relative number of widows and widowers is inflated by the large baby boom cohort. All survivors are assumed to live until the age at which their spouse would be eligible for early retirement.

for that year. By 1985, these benefits would have grown to between $107 million and $267 million (in 1983 dollars) in accordance with actual and expected employment growth. First-year benefit costs for 1985 would be in the magnitude of $69 million to $172 million, however. Actual first-year costs can be expected to be between $29 million to $72 million, since the provision is effective midyear. Benefit costs will increase gradually over the years as younger survivors reach early retirement age.

Although REA preretirement survivor benefit provisions are not costly on a national level, this provision could have a substantial impact on plans using early retirement to adjust their work forces and for companies subsidizing early retirement. Firms with a higher proportion of older vested workers would also have higher preretirement survivor benefit costs. Some have argued that granting preretirement survivor benefits to workers before early retirement age is a poor way to provide benefits compared to life insurance. Furthermore, employers affected by these costs might reduce other death benefits, such as life insurance, to keep total compensation costs steady. Such reductions could be detrimental to the survivors affected if life insurance pays more than the early retirement annuity. Furthermore, life insurance payments are immediate. Immediate payments particularly help young mothers and fathers who must adjust to the loss of a wage earner.

Table 5
Facts and Figures About Divorce in America

	1960	1970	1979
Divorce Rate (per 1,000 married women age 15 and over)	9.2	14.9	22.8
Divorced Person Rate (per 1,000 married persons)	42	60	120*
Duration of Marriage (median number of years)	7.1	6.7	6.8
For Women			
Median age at divorce	—	27.9	28.7
Median age at remarriage	—	33.3	31.9
Rate of Remarriage (per 1,000 widowed and divorced women)			
Age 14 and over	32.7	36.6	40.8
Age 14–24	407.7	317.6	312.6
Age 25–44	—	142.3	127.5
Age 45–64	22.0	24.8	21.0

Source: U.S. Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States, 1982-83*, table no. 124, p. 82; U.S. Department of Commerce, Bureau of the Census, *Marital Status and Living Arrangements*, March 1983, table C, p. 3.

* 1980 figure.

Pensions and Divorce

REA also sought to address the retirement income problems of divorced women who may have been depending upon sharing the pension benefits accrued by their husbands during their marriage as support in their old age. Policy interest in the problems of divorced women has been increasing with the spreading incidence of divorce. In fact, the divorce rate more than doubled between 1960 and 1979, from 9.2 divorces per 1,000 married women to 22.8 per 1,000 married women (table 5).[16] From a retirement income perspective, those divorced women of particular concern are older women who may have spent many years out of the labor force raising a family and who would not be entitled to pension benefits on their own.[17]

Since ERISA, a number of court cases have dealt with the allocation of pension benefits upon divorce. In 1980, the Internal Revenue Service (IRS) ruled that pension plan trustees could legally comply with court orders requiring payments to divorced spouses or children as part of alimony or child support awards. No ruling was made on future vested benefits. REA specified that in the case of certain domestic relations orders, including divorce settlements and legal separations, pensions could be divided upon divorce. Such payments would begin the first day that the plan participant attained the earliest retirement age under the plan, whether or not he or she actually retired.

The future use of these new provisions is hard to gauge. Pension benefits are probably regarded as either alimony or prop-

[16]The divorce rate has been rising for a number of years. An earlier bulge in the divorce rate was observed around World War II among women age 14-44. The rate then declined and remained relatively steady until the 1960s.

[17]The 1977 Social Security Amendments reduced the length of marriage needed to qualify for retirement benefits as a divorced spouse of a retired worker from 20 to 10 years. But the issue of benefit receipt on the part of divorced wives is still an important factor in the development of earnings sharing proposals, currently under study by the Social Security Administration, as a means of better allocating Social Security entitlement among husbands and wives.

erty. These awards follow very different patterns. In 1981, only about 16 percent of the 14.2 million ever-divorced women were awarded alimony.[18] An even smaller proportion, only 4.5 percent or 635,000 women, were supposed to receive payments in 1981.[19] A far higher proportion of divorcees, about 42 percent, were awarded a property settlement. Consequently, the potential for the future use of the divorce provisions of REA is broad. If pensions are treated as alimony, they will be of minor importance for most divorces. If they are regarded as property, the impact of this legislation could be far-reaching, since only 15 percent of property settlements are settled in terms of cash alone.

If pensions are treated as alimony, they will be of minor importance for most divorces. If they are regarded as property, the impact of this legislation could be far-reaching, since only 15 percent of property settlements are settled in terms of cash alone.

The divorced population is very diverse. The median duration of marriage before divorce has been declining steadily over the years that the divorce rate has been rising. A median marriage in 1979 of 6.8 years suggests that many divorced women will not have been married to husbands with vested private pension benefits. This supposition is further supported by statistics showing that women get divorced at a median age of under 30.

Many divorced women also remarry. Although the age at divorce has risen slightly, the age of remarriage has declined by about a year and a half. This trend probably explains the increasing total remarriage rate among women age 14 and over in the face of decreasing marriage rates for every age group. Remarriage rates are extremely high for younger divorced women and very low for older divorced women. In sum, these statistics suggest that, within the divorced population, many young women will quickly remarry, while some older women will remain divorced throughout their lives.

Among the 848,000 currently divorced women old enough to receive Social Security, 16 percent receive pension income as a worker or survivor (table 2). Since this rate is higher than that experienced by widows, most of these benefits are probably earned on their own. (The only women with a higher private pension benefit receipt rate are never-married women.) Divorced women also tend to have relatively high rates of labor force participation and high rates of pension coverage. Nonetheless, average pension benefits received by divorced women are lower than those received by other marital status groups. Whether REA will serve to increase these benefits remains to be seen.

Conclusion

Provisions in REA to increase participation affect relatively few workers. The new ERISA participation standards that include young workers will provide vested benefits for at most 325,000 young men and women. Slightly over half are expected to be young men. While the actuarial costs of lowering participation standards to age 21 are estimated to be $233 million, increased administrative costs could double or triple that figure. The most costly provision of the REA may stem from the break-in-service provisions, because of the extensive additional recordkeeping involved, but a dollar estimate is not possible.

The effects of REA on spouses, surviving spouses, and divorced spouses is extremely uncertain without more information about how married couples make these decisions. The percentage of widowed women receiving private pensions could climb to the rates for married men. Similarly, young widows reaching early retirement age could receive pension benefits at rates approaching those for middle-aged married men. Benefit receipt may be limited, however, and may come at the expense of company-financed life insurance payments. Finally, depending on trends in divorce settlements for women who divorce at older ages, their pension income could approach that of older widows. Postlegislative information will be the final arbiter of the impact of these amendments on older women.

[18] U.S. Department of Commerce, Bureau of the Census, Current Population Reports, Series P-23, no. 124, *Child Support and Alimony: 1981 (Advance Report)* (Washington, DC: U.S. Government Printing Office, 1983).

[19] Although this in no way provides the full answer for this difference, 55 percent of ever-divorced women remarried.

ITEM 6

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STATEMENT SUPPORTING PENSION REFORM

SUBMITTED TO THE

SPECIAL COMMITTEE ON AGING

UNITED STATES SENATE

BY

THE INSTITUTE OF ELECTRICAL AND ELECTRONICS ENGINEERS, INC. (IEEE)

THE AMERICAN INSTITUTE OF CHEMISTS (AIC)

THE AMERICAN SOCIETY OF CIVIL ENGINEERS (ASCE)

AND

THE AMERICAN SOCIETY OF MECHANICAL ENGINEERS (ASME)

June - 1985

The IEEE, AIC, ASCE, and ASME commend the initiative of the Chairman in holding hearings on the need for greater equity in existing pension/retirement plans and the need for a national retirement income policy. In order to address ourselves to the many broad issues in a useful manner, our statement is limited to the issues of vesting, integration, portability, and defined contribution pension plans vs. defined benefit pension plans.

This statement represents the views of the memberships of IEEE, AIC, ASCE, and ASME who feel that existing pension laws are inequitable and unfair to engineers, scientists, and similar mobile individuals. The IEEE, which celebrated its centennial anniversary 1984, is the world's largest technical professional society, representing over 250,000 members. The AIC is a society of 5,000 professional chemists founded in 1923 which includes three members of the House of Representatives among its distinguished Fellows. ASCE is the oldest technical professional society in the United States, representing 100,000 members. ASME is a non-profit, educational, scientific, charitable society, founded over 100 years ago, whose membership of Mechanical Engineers and students exceeds 110,000. Our societies, who collectively represent almost a half million engineers and scientists, are an established and highly respected part of the nation's scientific and engineering infrastructure.

VESTING

The essence of our problem is embodied in the conflict between common vesting requirements and existing work patterns of our memberships, and other similarly mobile workers. The majority of our members are employees of corporations and are participants in employer pension plans that utilize ten (10) year cliff vesting; however, the average time spent with a single employer is considerally less than ten (10) years. Mr. Chairman, we assure you that we are not "flighty people". It is simply a fact of modern life that technical professionals are frequently hired to solve specific technical problems; and, when those problems are solved, we move on. That is in the interest of the country, its productivity, its technological advancement, and its economic growth.

But, the price we pay for the fluid employment pattern in our profession is repeated pension forfeiture. Indeed, many of our members change employers again and again, forfeiting pension after pension, and thus find it difficult to become vested in an employer pension plan. This scenario is a fact for our memberships and unfortunately is even more of an acute problem for workers that are faced with greater mobility than engineering and scientific professionals -- e.g. women.

<u>Therefore, Mr. Chairman, we recommend that ERISA vesting requirements be modified to require full vesting after an employee has completed one year of service, with credit being retroactive to the commencement of employment.</u>

SOCIAL SECURITY INTEGRATION

The effects of integration of social security benefits with those provided by an employer-sponsored pension plan are confusing and difficult for most pension participants to understand. In many cases, an integrated plan may assure that lower paid workers receive little or nothing from their employer pension plan; however, this knowledge and understanding is generally discovered by the employee only when it is too late for remedial action.

It is our position that the integration of government and private plan benefits:

(1) invariably reduces the benefit provided by the private plan;

(2) effectively provides a disproportionate loss of private pension benefits to lower paid employees and a concomitant gain of private plan benefits to highly paid individuals; and,

(3) adds a substantial degree of complexity to pension plans, which mitigates against the clear understanding of plans by plan participants.

Therefore, we oppose integration of private and government benefits.

PORTABILITY OF VESTED PENSION BENEFITS

As mentioned in previous paragraphs, our members often forfeit pension benefits because of lack of vesting; however, on those rare occasions where they do become vested, an additional complication arises from the characteristic mobility. In the situation where an employee does manage to vest, the benefit is often exceedingly small unless the employment period is quite lengthy (e.g. 30 years). A mobile employee who may have been fortunate enough to vest in several pension plans during the course of a career finds that these vested benefits are individually worth very little, and are reposited with a multitude of different pension plans. Pension portability would allow these fortunate mobile employees to take their vested benefits with them as they move from employer to employer, thus giving them the benefit of one repository for these increments of vested benefits. This in turn would allow the mobile individual to accrue these vested retirement benefits in much the same manner as an employee who is not mobile and thus accrues vested benefits in only one employer's plan. This type of single repository would permit the employees to benefit from the larger accumulation of retirement monies and subsequent benefits of interest compounding over the span of a career. However, there may well be cases in which an employee may wish for the vested benefits to remain with the employer's pension plan, and this should be allowed.

Therefore, we support portability for all vested pension benefits, at the option of the employee.

DEFINED CONTRIBUTION PENSION PLANS

A basic objective of pension benefits is to provide an income sufficient to maintain a reasonable standard of living after an individual retires. Unfortunately, for mobile employees like engineers, this objective is often not met because of the basic nature of defined benefit pension plans. Under these plans, benefits are fixed when employees separate from their employers. The effects of inflation are to reduce the value of benefits over time. Under the system of Defined Contributions, however, portability is a realistic goal through those penson plans with early participation and early vesting. In addition, an individual's benefit would not be frozen but would be commensurate with the plan investment return and would grow over the individual's career. Indeed, there are advantages to both the employee and the employer:

For the employer (simplicity):

* there is no need to designate a normal retirement age, and no actuarial computations are required for active employees, thereby resulting in a small expense saving;
* pension costs are always fully funded, and future costs do not need to be estimated; and,
* the plans are not subject to termination insurance, and there is no contingent liability if the plan should terminate.

For the employee (flexibility and possible portability):

* the participant can watch the account grow, and can, at any time, calculate its current value; additionally, unlike the defined benefit plan, the defined contribution plan does not have the risk of forfeiture;
* the participant can usually choose from a range of options on how to invest the account;
* the account fund continues to grow, even after the participant's employment terminates; and,
* the entire account balance is available as a death benefit.

Therefore, we support legislation that would encourage new industries to offer defined contribution pension plans; in the case of existing defined benefit pension plans, we would encourage employers to start to make available defined contribution plans to new and existing employees without any loss of existing benefits deriving from defined benefit plans.

SUMMARY OF POSITIONS

Mr. Chairman, we recognize and commend actions taken in recent years by the Congress to assist individuals to save for their retirement. The expansion of IRA availability to all working individuals was a major step forward in encouraging people to provide for their own retirment through investment in these tax-deferred savings vehicles; however, we feel that there is much more that needs to be done to bring equity into the pension/retirement system. Thus, based upon the philosophies espoused in the foregoing pages, the IEEE, AIC, ASCE and ASME ask that the Special Committee on Aging support legislation that would:

(1) Mandate full vesting after one year of employment, with credit being retroactive to the commencement of employment.

(2) Eliminate integration of social security with private pension benefits.

(3) Provide for portability of vested pension benefits, at the option of the employee; and,

(4) Encourage new employers to offer defined contribution plans, and encourage existing employers to offer new and existing employees the option of the defined contribution plan without any loss of existing benefits deriving from defined benefit plans.

Mr. Chairman, this concludes our testimony on behalf of the IEEE, AIC, ASCE, and ASME. We look forward to working with you, your colleagues and staff on these issues of concern to our memberships.

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